



ISLAMIC DEVELOPMENT BANK  
ISLAMIC RESEARCH AND TRAINING INSTITUTE

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# LESSONS IN ISLAMIC ECONOMICS

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Volume [ 2 ]



*Seminar Proceedings  
No.41*

# 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.

## Functions

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'ah* in 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.

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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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ISLAMIC RESEARCH AND TRAINING INSTITUTE**

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***CHAPTER FIFTEEN***



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# ORGANIZATION OF PRODUCTION AND THEORY OF THE FIRM

*Munawar Iqbal\**

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## Introduction

The process of production is a process through which inputs are converted into outputs. It requires some organizational arrangement whereby various factors of production can be combined to produce output. If the factors of production are owned by more than one party, their combination will have to be governed by some contractual arrangement defining the rights and responsibilities of each party. The Islamic law of contracts is very rich in this regard. It contains a number of organizational forms and provides detailed instructions about the rights and responsibilities to various parties in each contract. In the first part of this paper, we briefly review some of these forms of production organization.

From an economic point of view, we are more interested in the process of decision making within a firm. A firm in this context means any organization which converts inputs into goods and services and sells them on the market. Behavior of a firm is crucially dependent on the form of production organization i.e. the contractual arrangements governing the relationship of the owners of various factors of production at the disposal of the firm. In economic literature we find a number of theories of the behavior of a firm. In another section of the paper we will examine some of these theories in the light of the Islamic law of contracts governing various forms of production organization.

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## Forms of Production Organization

From an Islamic point of view, there are four major organizational structures: Owner Proprietorship, *Sharikha Mudharabah* and *Ijarahh*. Before we describe these forms in some detail, it must be mentioned that the major emphasis of Islamic law is on the determination of rights and responsibilities of various parties to a contract. In case of production organization, Islam recognizes the fact that the process of production is characterized by uncertainty. This uncertainty gives rise to any risks. Someone has to take the responsibility of such risks before production can be undertaken. Difference in the arrangement for sharing of this risk is the most important distinguishing feature among various forms of production organization.

Owner proprietorship, as the name signifies is a form of production organization in which all factors of production are owned by an **individual** and all production decisions are taken by him. He is owner as well as the manager of the firm. He is also the one who takes all the risk.

In *Mudharabah* one party contributes capital and is called *Rabb-al-mal* and another party contributes management (or entrepreneurship) and is called *Mudharib*. The parties can agree (at the time of entering into the contract) on any ratio in which they would share profits. However, in case of loss, the financial loss will be borne by the *Rabb-al-mal* while the *Mudharib* will lose his labor. While the entire responsibility of loss rests with the financier, his liability is limited to the amount of capital that he contributed to the firm and the responsibility of *Mudharib* is limited to his labor, except in cases where he fails to follow the conditions set by *Rabb-al-mal*.

*Ijarahh* is an arrangement in which some factors opt for a fixed rental. They do not bear business risk and do not claim a share in profit. Here the principle is that the rental (or wages in case of labor) must be fixed in advance and must be paid irrespective of the outcome of business enterprises.

### Kinds of *Sharikah*

*Sharikah* is the most important form of business organization. The basic principle on which *Sharikah* operates is the concept of *Wakalah* (agentship). There is mutual delegation of powers. Each partner delegates powers of decision making to the other. Hence, each partner can act on behalf

of the other. However, the extent of this mutual delegation of powers varies in different forms of *Sharikah*.

*Sharikah* can take a number of forms. The first one is known as *Sharikah-al-Mufawadah*. It can be loosely translated as unlimited partnership. It is unlimited in the sense that the mutual delegation of powers among the partners is unlimited. In addition, each partner is also a "kafil" (Surety/Guarantor) for the other in all financial matters. The conditions for forming a *Mufawadah* partnership are very strict. All the partners should be equal in almost all respects. They must participate with equal capital and effort. They should have equal freedom of action. They should have equal status etc. Thus a *Mufawadah* partnership cannot be formed between a free man and a slave, nor between a minor and one of age, nor between a Muslim and a non-believer. In view of these conditions, *Mufawadah* is a very specific form and its practical scope is limited. Moreover, of the four major schools of Islamic jurisprudence, *Mufawadah* belongs to the Hanafi school.<sup>1</sup>

The second and the most important form of *Sharikah* is *Sharikah-al-'Inan*. *'Inan* literally means 'reins' of a pack animal. The term is applied to that form of *Sharikah* where the mutual delegation of authority among partners is limited (restrained). Like the rider who holds the reins with one hand and does something else with the other, each partner transfers to his colleague the reins of disposition for only a portion of the capital. *Sharikah-al-'Inan* is a much broader form of business organization. In this form the partners do not have to be of equal status; they do not have to contribute equal capital; they do not have to share the profit in equal proportion. From a practical point of view, it is a useful form. Juristically also, it is permitted by all schools of *Fiqh*.

Another classification of *Sharikah* can be by the kind of capital that is its basis. For example, there can be *Sharikah-al-Abdan* where the basis of participation is not financial capital but skill. Two people, for example an electrician and a plumber, can form *Sharikah-al-Abdan*. This is also called *Sharikah-al-Sana'i*.

Another kind which also has wide usage and application, especially in the modern day worlds is *Sharikah-al-wujuh*. *Wujuh* means credibility. *Sharikah-al-Wujuh* is an arrangement where none of the parties has capital and

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1. In Maliki *Fiqh*, *Mufawadah* is permissible, but the term is used with a different meaning.

they participate on the basis of credit. They would seek credit on the basis of their reputation and then carry on business on the basis of that credit.

### **Traditional Forms and Their Modern Application**

The traditional forms of production organization provide a useful basis of mutual cooperation among various factors of production. The contractual responsibilities of each party are carefully laid down for each form. The *Fiqh* literature is also rich with respect to the conditions which have to be fulfilled in order to have legitimate *Sharikah* or *Mudharabah* etc. One is astonished to see the richness and flexibility of *Fiqh* literature to suit the requirement of people and find legitimate forms of business organization under changing circumstances. The same kind of ingenuity is required today to cope with the complexities of modern day business. A number of forms that we find today may not fit the description/conditions of a single contract. They are combinations of two or more of the above mentioned forms. Therefore, Islamic scholars have to determine the legitimacy of these mixed forms as well as the rights and responsibilities of the parties under these contracts. In the following paragraphs, I present some interesting cases from modern business forms.

As mentioned above, in the pure case of *Mudharabah*, one party contributes capital and the other provides entrepreneurship. However, in modern day world we find that most often the business is not restricted to the initial capital provided by the *Rabb-al-mal*. A lot of business is conducted on the basis of credit. Suppose Zayd forms a *Mudharabah* with Bakar with one million dollars. Under the strict rules of *Mudharabah*, with Bakar with one million dollars. Under the strict rules of *Mudharabah*, Baker is allowed to do business with only that one million. However, what happens practically is that he starts business with one million dollars but gradually increases his circulation to say ten million on the basis of credit. What we have here may be a combination of *Mudharabah* and *Sharikah-al-wujuh* or a *Mudharabah* turning into a *Sharikah-al-wujuh*. Therefore, the mutual rights and responsibilities have to be determined accordingly. In case of *Mudharabah* and responsibility of the *Rabb-al-mal* is limited to the extent of his capital i.e. if there is loss he is only liable to the extent of his capital. In principle, this implies that a *Mudharib* is restricted to work with the initial capital alone. This, as mentioned above, has limited practical application today. If practically the business is run as explained in the above example, either the *Rabb-al-mal* would be considered to have permitted (either explicitly or implicitly) the *Mudharib* to take credit in which case his responsibility will not be limited to the initial capital or the arrangement may be

considered *Sharikah-al-wujuh*, if that is mutually agreed and again the liability would be unlimited.

In case of a joint stock company we face a similar problem. In joint stock companies, the responsibilities of loss is limited to the contribution of each shareholder in the capital of the company. If the loss of a company exceeds its assets, the company is declared bankrupt. No recourse is possible to the assets of shareholders other than their share in the company. In terms of financial liabilities, it resembles the Islamic *Mudharabah* contract. But can a joint stock company be considered to be governed by a *Mudharabah* contract and hence a limited liability company? I do not think so. As a matter of fact, it is more similar to *Sharikah* because the shareholders, through their representatives, also manage the company. If this is the case, then the concept of limited liability cannot be applied to joint stock companies because in case of the *Sharikah*, the responsibility is unlimited. It should be clear here that even under *Mudharabah* contract the concept of limited liability is an internal matter. As far as third parties are concerned, the liability remains unlimited.

Islam protects the rights of all. The creditors of the company must have a recourse to somebody, whether *Rabb-al-mal* or *Mudharib* (or even state under some new institutional arrangement). Thus whether we have a mixed form of *Mudharabah* and *Sharikah-al-wujuh* or a joint stock company, we cannot have limited liability. Because of the same reason, if the shareholders of the company have extra-company assets, the creditors should have their claims settled from them. Only if the total assets of a shareholder are insufficient to meet his liabilities should be allowed to declare himself bankrupt. In other words, it should be determined separately and not jointly. It may be noted that even in case of a genuinely bankrupt person, Islam protects the rights of creditors through a permanent head for bad debts under the *Zakah* disbursement system.

As a third example, consider the model of an Islamic bank. As we know, it is organized on the basis of a two-tier *Mudharabah*. The relationship between depositors and the bank is governed by one *Mudharabah* and the relationship between the bank and the investors is governed by a separate *Mudharabah* contract. The arrangement finds legitimacy from the principle *Al Mudharib Yudarib* i.e. a *Mudharib* may use *Mudharabah* capital to enter into another *Mudharabah* contract with someone else. An Islamic bank is organized on the same principle but it covers even a more subtle relationship. In fact, organization of an Islamic bank on the basis of a two-tier *Mudharabah* is an

excellent example of adapting traditional forms of contracts to modern requirements.

Combination of various permissible contracts, opens up a large variety of organizational structures which can handle modern business requirements. A large number of transactions involve future sale and purchase. Many a times it is maintained that simultaneous future sale and purchase is speculative and, therefore, not permissible. The issue needs a more careful consideration. Perhaps by combining two permissible contracts, a legitimate form can be found to handle future sale. Let us examine the following arrangement.

Under *Bay'Salam* it is permissible to make payment at time to and get delivery at time to. Now suppose a car dealer has entered into *Salam* contracts with various parties for purchase of cars. He will have a time schedule of delivery of cars. He would know that he would be getting so many cars in next January and so many cars in next February etc. Now suppose he enters into independent *Salam* contracts whereby he would sell cars in next January, February etc. and get payment today. He is buying in future and simultaneously selling in future. It is a combination of two independent *Salam* contracts. This perhaps could be one way of handling legitimate needs of future trade. The important thing is that the two *Salam* contracts should stand on their own. In other words the car dealer cannot link the second *Salam* with the first. He would be bound to deliver cars to his customers on time irrespective of the result of his own purchases under the first *Salam* contract. As long as they are two separate *Salam* contracts, valid independently, I think no *Shari 'ah* rule is violated and the combination may be used to handle "real" transactions in future.

The point that is being made here is that the pure or simple forms of contracts available in Islamic literature could be combined to derive new organizational forms to cope with the complexities of modern day business. But a note of caution should be added. While combining of two (or more) contracts is permissible in principle, one has to be careful. There may be cases where two contracts, taken separately are perfectly legitimate but taken together they would become illegitimate. As an example, let us take the case of *Bay'Ina* which works as follows:

Zaid sells a commodity to Baker for say \$100/- on cash payment and Baker sells the same commodity back to Zaid for \$120/- on deferred payment

basis. Now as two separate contracts, each one is legitimate. Zaid is allowed to sell something to Bakar for \$100/- and Bakar is also allowed to sell to Zaid on deferred payment basis for \$120/-. But taken together it is just a roundabout way of borrowing on interest. Trading was never the real purpose. Bakar did not want to buy the commodity and Zaid did not want to sell it. Bakar did not want to buy the commodity and Zaid did not want to sell it. Bakar had the money and Zaid needed it. The end result is that Bakar lent \$100/- and received back \$120/-after some time. This is similar to *Riba* and hence the arrangement is not permissible. Therefore, while combining two contracts, we have to be careful. Each one of them should involve genuine and not fake trade. The combination should not violate any *Shari 'ah* principle. Within these constraints, it is desirable to develop new contractual arrangements to handle modern business complexities.

### **Towards an Islamic Theory of the Firm**

While the main concern of the jurists is with the determination of the rights and responsibilities of various parties in a contractual arrangement, the economists are more interested in decision making. We will see that the two are closely related because the Islamic view of contractual responsibilities have important implications for the theory of the firm. A firm, we know, is the decision making unit in the field of production. How does it behave while taking various production decisions? In the traditional economics there are three major strands of the theory of firm: (i) The neoclassical theory, (ii) managerial theories, and (iii) behavioral theories. This is not the place to evaluate these theories nor an alternative Islamic theory of firm's behavior could be offered at this stage. The work done in this area, so far, is very little and it will take some time to have a well developed Islamic theory of firm. Hence, in this section a few points which should be considered while developing an Islamic theory of the firm have been discussed.

The first and perhaps the most important issue is the question of goals of a firm. In the neoclassical theory the only goal of the firm is assumed to be profit maximization. All price and quantity decisions are taken such as to ensure the maximization is the sole objective of the firm. Different authors have suggested different objective functions that the firm tries to maximize. Unlike the neoclassical theory where the owner is also the manager of the firm, most other theories believe in a dichotomy or separation between the owners and the "managers" of the firm. Where such a dichotomy exists, the formulation of the goals of a firm becomes more complex because decision making is also split.

According to the managerial theories, the goals of the firm are set by managers and not by the owners. It is further argued that the managers are motivated by their self interest. Therefore, instead of maximizing profit, which goes to the shareholders, they maximize their own utility function subject to a minimum profit constraint. The minimum profit would be such as to keep the shareholders satisfied and ensure job security for the managers.

The behavioral theory goes a step further. According to this theory, there is not only a separation between the owners of capital and the entrepreneurs, there are in fact a number of interest groups within a firm each one having its special interests. The workers, the sales manager, the operational manager, etc., all try to fulfill their own interests. The firm is seen as collusion of these interest groups. The objective of the management is not to maximize profit but to satisfy. The top management tries to satisfy as many interest groups as possible and to the extent possible. Therefore, the goal of the firm is not to earn maximum profit. It has multiple goals: to have reasonable profit; reasonable salaries, reasonable sales and market share etc.

It should be observed that one thing is common to all of these theories. In each case the decision maker tries to maximize his own utility. If the decision maker is the owner proprietor, he tries to maximize profits. If there is a separation between the owner and the manager, and it is the manager who takes decision he would try to maximize his own utility. He would care about the profit of shareholders only to the extent that it is to his own interest. He works under a minimum profit constraint only because, if he does not produce that level of profits, he would be fired. Therefore, when he tries to earn a reasonable profit for the owners, he is in fact still serving his own interest.

From an Islamic point of view, the dichotomy between owners and managers is clearly recognized. In the case of *Mudharabah*, *Rabb-al-mal* is owner of the company while *Mudharib* has the decision making powers. However, the basis of Islamic separation is the concept of *Amanah* (trustworthiness). The *Mudharib* is an agent working on behalf of the owner in a trustworthy fashion. He will try to serve the interest of the company rather than his own selfish motives. The moral dimension which pervades the whole Islamic economic system also works here. The separation between ownership and entrepreneurship does not create vested interests. It only opens doors of cooperation among various factors of production to work together for a common goal and then sharing the fruits in a judicious manner.



The implication of the Islamic concept of *Amanah* is that addition of vested interests of managers/workers to the objective function of the firm is not acceptable. Whether the company is a partnership or *Mudharabah*, it is the interest of the company which is to be safeguarded. However, for reasons of their own, Islamic economists also feel uncomfortable with profit maximization being the only goal of an Islamic firm. They refer to the altruistic inclinations of the Islamic economic system. As against the "economic man", the "Islamic man" is not a selfish, egoistic being. He cares for others as well as for common public interest. These characteristics should somehow be accommodated in the formulation of the objective function of a firm.

Metwally who has made such an attempt has maintained that, "the principle of economic trusteeship in an Islamic economy is dramatically opposed to the self-interest principle which is the cornerstone of the free-market economies of non-Islamic societies. This clearly suggests that the object of an Islamic firm will not be profit maximization. Rather, the firm may be satisfied to realize a 'reasonable' or 'fair' level of profit if that enables it to achieve the more important goal of 'doing good to please God' .... The Good Deeds take many forms but basically they revolve around charity" <sup>2</sup>. Accordingly he suggests an objective function for an Islamic firm of the following form:

$$Y = Y(F, G) \text{ Where}$$

$$F = \text{level of profits}$$

$$G = \text{expenditure on "charity" or "good deeds"}$$

The firm's aim is to maximize this function subject to a minimum acceptable level of profits to satisfy its owners and maintain its business.

While agreeing that in an Islamic economy people have altruistic attitudes, it may not be appropriate to include the expenditure on charity in the objective function of an Islamic entrepreneur especially when he is not the owner. In view of the separation of ownership from entrepreneurship, one has to keep in view the limits of authority indisposition of the capital of a company that a *Mudharib* or partner has. Islamic jurists are unanimous in maintaining that a partner does not have the right of "*tabarru*" (charity) out of common funds. The same applies to a *Mudharib* with respect to the capital of *Rabb-al-mal*. He

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2. Metwally, M.A. A Behavioral Model of An Islamic Firm, Centre for Research in Islamic Economics, King Abdulaziz University, Jeddah, Research Series in English No.5.

is not even allowed to give *Qard Hasan* out of the capital of the company. Islamic jurists have explicitly stated that the basic reason for which the *Rabb-al-mal* has given him the money is to make profit<sup>3</sup> and it is in the light of this overall aim that the extent of the freedom of a *Mudharib* or a partner is to be determined.

Another important question which is common to all traditional theories of the firm and which needs to be reconsidered from an Islamic point of view is that while talking about the theory of the firm, the financing part of firm's decision making is almost always ignored. It is assumed that the operational decisions of the firm do not depend on how the firm is being financed. According to the well known Modigliani-Miller Theorem, the debt-equity ratio of a firm does not have any significant influence either on the output level of the firm or on the value of its shares etc. The method of financing, whether through debt, or through shares, is a portfolio decision which is taken independently and does not have any implications for operational decisions and hence the equilibrium of the firm.

Because of the cardinal importance of the prohibition of interest in an Islamic economy, the question is of crucial importance. In the absence of bonds, how would a firm finance its activities and whether that decision has any implications for the equilibrium of the firm needs careful study. As a matter of fact, it has been shown that the financing decision does have a bearing on the equilibrium level of the firm. Using a model developed by Adrian Wood<sup>4</sup> and modifying it for an Islamic economy, Badal Mukharjee has shown that a Zero Rate of Interest Economy (ZRIE) generates equilibria that involve higher growth rates and lower profit margins than an economy having positive rate of interest. Out of the three sources of funds - borrowing, undistributed profits and equity financing - only the last two are available in ZRIE. When borrowing are replaced by equity financing, a significant change is introduced on the supply side of funds. This change has been shown to have important implications for the equilibrium of a firm<sup>5</sup>. This is a promising new area and a theory of firm behavior from an Islamic perspective needs to accommodate both the financial and operational decisions.

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3. For example see Sarakhsi: *Mabsut* Vol. II, p. 179 and Kasani: *Bida-A-Sana'i*, Vol. VI, p.57.

4. Wood, A: *A Theory of Profit*, Cambridge, 1975.

5. For details see: Badal Mukharjee, *Theory of Growth of a Firm in a Zero Interest Rate Economy*, Centre for Research in Islamic Economics, King Abdulaziz University, Jeddah, 1984.

These are some of the issues which, along with others, have to be addressed while developing an Islamic theory of behavior of a firm. As mentioned before, at this state, it is not possible to offer a well-developed theory. We find bits and pieces here and there and a lot of work would be required to put them together into a coherent theory.

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## DISCUSSION

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### Comments

Thank you, Dr. Munawar Iqbal, for the excellent presentation. Could you possibly explain points one, two and three as, I do not find any difference between the functions of an Islamic bank and the Islamic forms of business organization or production organization. As for the fourth point, I cannot say because the other points are not clear to me. I do not find any difference between the Islamic way of production organization and the conventional form of production organization.

I would like some details of particular points, i.e., the concept of sharing, the separation of ownership with the management and who is to deal with the problem of moral hazard. I think that there is no basic difference with the conventional theory because as you have pointed out, in any type of business organization, if there is any risk there may be profit or there may be loss. In what way is the Islamic way of production different from conventional production in the economy? Could you explain this please. Thank you.

As far as the differences between the conventional way of production organization and the Islamic way of production organization is concerned, there are not many differences. The difference is in the approach and, as I mentioned from the Islamic point of view, the pure forms of *Muradaba* and *Musharika* are not relevant for the complex modern day production structure. Therefore, there are a number of combinations which are being used.

However, I did draw a certain distinction between the behavior or attitude of an Islamic form or an Islamic system towards the modern production organization, and I draw your attention to the example of the joint stock company which is based on the concept of limited liability. As you know the joint stock company is the most extensive form of production organization in the modern world. All of you are aware that it is based on the concept of limited liability, and I point out to you and that it is unfair and unacceptable from the Islamic point of view, because stock companies are *Musharka* by nature and the liability is unlimited. Even if they were *Mudaraba*, the liability as far as third parties are concerned would be unlimited.

I also draw your attention to the fact that in today's business practices, the liability is limited only to the assets in that particular company. that is they are restricted to the company, not to any individual. In an Islamic economy, the liability is restricted to the individual, not to the company. Therefore, if I have shares in 100 companies in a conventional framework, in each of the companies, my liability will be limited to my share in that particular company. But in the Islamic framework, my liability will extend to all my shares in all the companies.

### **A Participant**

My first question is: What about the trade unions? You did not talk about their role.

My second question is: What about the pay structure for the welfare of the firm?

### **Dr. Iqbal**

As far as trade unions are concerned, they are not prohibited in the Islamic framework. However, I would like to mention that in the Islamic framework, in the Islamic economy, all people have their responsibility. We say that the producer is responsible for providing labor with a reasonable work atmosphere. He should not overburden his workers and should pay them what they are due. These are the responsibilities of the owner or producer.

At the same time, there are responsibilities on the part of the worker. If they are getting a wage, they should work honestly. They should try to do their best in promoting the interest of the firm.

Therefore, the attitude of trade unions in capitalist countries differ from the Islamic point of view. However, trade unions are not prohibited. If they are only bargaining units, i.e., bargaining agents, which try to promote the interests of their members by negotiating their service conditions with the owner, this is perfectly permissible. However, they should not disturb the industrial peace. They should not become involved in lockouts and things like that. They can negotiate as hard as they can, this is their right. On the other hand, it is the right of the producer that after he has paid their salary, the workers should also work honestly and hard according to their ability.

Secondly, as far as the pay structure is concerned, I mentioned that the guiding principle is that reward should be in according to the contribution. Some one who has contributed more should be paid more. Someone who has contributed less should be paid less. How is this contribution determined? There are two different theories. One is marginal productivity and the other is average productivity. This has to be decided by the economist, not by the jurist. Whatever method is more appropriate from an economic point of view may be adopted.

### **A Participant**

If you, Brother Iqbal, can draw some lines in the production function, is it possible to incorporate moral hazard as one of the distinct variables? If it is possible, then can we theoretically expect to have any distinct impact on production? Will it be positive or negative or do you think that moral hazard will not affect the overall production or the distribution of production? Thank you.

### **Dr. Iqbal**

First, I will discuss the problem of moral hazard. I will then cover the dichotomy or separation between ownership and management which is the case *is Mudaraba*, the separation between owners and managers. In the Islamic framework, the ultimate solution to the problem of moral hazard is to improve the morality of society and to increase the level of trust. I mentioned that in the *Fiqh* literature, the agent is called Ammen. He is supposed to be Ammen. Ammen is one who will act just as he would for his own sake. Whether this is possible or not in the present day, I do not know. Realistically speaking, we have to consider the case of imperfect morality. However, our advantage as compared to other systems is that Islam places a lot of emphasis on morality and there are built-in institutions within the system, such as, prayers, Amarul Bil Maruka Inka, the paying of *Zakah*, social pressure, etc. This is number one. The notion exists in the present world and this is unfortunate because it gives rise to the problem of imperfect morality.

Secondly, in addition to the promotion of morality in the Islamic system, the *Fiqh* literature in Islam is very rich as far as the rights of the agent are concerned. For the modern business firm where the same kind of dichotomy appears, their rights are not as well defined as in the case of the Islamic concept of *Mudaraba*. There is a large amount of literature which defines in great detail,

the discretionary power of an agent. Therefore, what I mentioned was the Islamic concept of *Mudaraba* in which the separation between ownership and management is better placed as compared to the secular model where similar separation takes place because of rich and strong contractual liabilities which have been placed on the agent. If those are observed, there is very little room for an agent to have discretionary power. This is the second point.

Thirdly, instead of these two, realistically speaking, as I mentioned, there will be cases of imperfect morality. How can we deal with them? I said that the managerial theories of the firm have suggested certain ways and means and again, as I mentioned, there are certain counter-arguments to these suggestions. However, they have their utility; they are not completely useless. I mentioned two of these: One is giving incentives to managers and the other is rewarding their performance with fixed salaries. By the way one article shows that the best arrangement in the case of such a dichotomy between management and ownership is a profit-sharing arrangement rather than a fixed salary for the managers. So, this is another way. Instead of giving managers a fixed salary, you tie their return to their performance.

The research shows that in the case of dichotomy, the optional arrangement is profit sharing rather than fixed salary for managers. Profit sharing means that the manager gets a variable return, so his salary or his remuneration is tied to his performance. This is the result and this is one way which has been suggested of dealing with moral hazard problem.

#### **A Participant**

I have a comment and a question. First, regarding moral hazard in Islam, we have many systems. We want to be sure that people have morality with the support as a Muslim helping each other without cheating, for the manager and the owner. Secondly, if you do not have morality, I suppose we have some procedure to debt any immoral thing because I think that if he does not have that moral to fix the man, the owner should be compensated if he could prove that Manager caused the level of profit to drop. He can be eligible to compensate the owner. This is well-known and said that for the *Mudharib* if he was the reason or if he has the cause not only for the loss, but for the low level of profitability, the owner is compensated by the *Mudharib*. Therefore, we can have that contract which minimize the moral hazard by incentive or we have debtor function in that contract. Also, I have a comment about the form of production organization. Brother Munawar Iqbal almost closed the door on

limited liability and this is well-known as the modern form of the organization for the production firm. Because there is a reason behind that for me as a shareholder, I have nothing to see for the management side. In the autonomy, I will just sit there and say Yes or No on my voting, I am one shareholder, I have nothing to do in that. So, if this company accrues some loss behind my ownership share value, should I compensate for something either or nothing to say on that went its kind of body of the personality of the ownership of the limited ownership, if you want to say that is not an Islamic issue, we should have some measure to prevent the excess loss of this shareholder who has nothing to do on decision making and supervision, in order to save from the mistake of the Manager.

### **Dr. Iqbal**

My considered opinion is that the concept of limited liability, and this is from *Fiqh* literature under *Musharakahh*, is very clear. In the *Musharakahh*, the liability is unlimited and the joint stock company is a partnership. It is a *Musharakahh*. Therefore, the liability has to be unlimited. How can an individual shareholder be protected? Well, the company is run by agents of the shareholders, and the board of directors is chosen by the shareholders. The small shareholder, of course, will only have that voting power equal to the extent of his shares. However, it is a democratic election and they can pool their votes and elect their own director, or the board of directors. It is their problem. If they have invested their money, they have to find ways and means to protect their interests and there is a mechanism available to protect their interests. The board of directors is a representative of the general body of the shareholders, big or small, and they are represented there according to their voting power. If they are small and it is clear that their interests will not be protected, then they can pool their votes and get a sufficient number of directors on the board.

If I have only one share and I know what is good for this company, then someone with a large amount of shares will not listen to me because he has other objectives for maximization and wants the company to follow certain policies. Is this clear?

If you, as one of the shareholders, give some advice that is good for the company and if it is actually good for the company, then they should adopt it. So the value of your suggestion depends upon whether they really think that your suggestion is good for the company. If there is a vote, then you have to go by the majority.



## **A Participant**

The presentation made by brother Munawar Iqbal has been very important. Muslim countries today face the problem of industrial development and the mobilization of capital by ensuring appropriate and healthy stock exchange activity. The Middle Eastern countries have plenty of capital. This capital is being invested in areas of the World other than the Muslim countries themselves. Now it seems that the development of healthy stock exchange activities by establishing centres of stock exchange in Muslim countries will be helpful in overcoming this situation. This is my first point and I would appreciate a comment by Dr. Iqbal on this. Secondly, he has mentioned profit sharing for managers.

I suggest that we also consider profit sharing among workers particularly for containing the discontent of workers. These days we notice that whenever some new industrial efforts are undertaken, the initial hazard is the misguiding of the trade unions. There is, of course, discontent among workers but also are busy bodies who try to misguide workers by ensuring that there a power struggle between trade union members, on the one hand, and investors on the other hand. So this seems to be an important consideration.

## **Dr. Iqbal**

I agree with both of your suggestions. The second one, profit sharing among laborers, I mentioned towards the end of my lecture, i.e., give them bonus and give them part of their salary as fixed wages and beyond that they should be made partners in profit by giving them bonuses. However, I did not mention that it should be left to the workers himself as to whether he wants to have a higher fixed wage or a slightly lower fixed wage, plus a share in the profit. So I agree with you that this is a better way of organizing from an Islamic point of view. There is a well-known book by Martin Viewsman called Sharing Economy. In which he advocates the case of profit sharing among laborers and owners of the firm.

As far as your other comments are concerned, the stock exchange is an extremely important requirement for an Islamic economy. As you know in an Islamic economy, interest is eliminated and most fixed rate return notes are undesirable. Therefore, equity becomes a very important mode of investment which makes the development of the stock exchange extremely important. At present, there are very few stock exchanges in Muslim countries. This is one of

the reasons why Islamic banks, are unable to enter into profit-sharing modes because there is no secondary market. Once Islamic shares and stock exchanges are well established, Islamic banks will be able to go into that mode. This is one of the most important institutional requirements of the Islamic system.

Firstly as far as profit maximization is concerned, it should be allowed. The constraining principle of "*La darara wa la Dirar*" applies to all Islamic economic activities in that any agent, any decision maker, who has to take a decision, whether it is a consumer, producer, government or anyone has to work within the *Shari 'ah* limit. That constraint is something which is standard and given. However, within the *Shari 'ah* the principle of *Ladra Avla Darar* will apply to every decision maker and to any other person for that matter. The prohibition is that they cannot maximize profit by using interest; they cannot maximize profit. I have mentioned that these kinds of constraints are placed by the *Shari 'ah*. They apply to all decision makers, and I agree that they also should apply to the producer. However, within the *Shari 'ah*, they are allowed to maximize the permitted limits of profit.

Secondly, I fully agree with your view of the accountability of the agent in the Islamic economy. I mentioned that there are very detailed guidelines given in the *Fiqh* prescribing the limits, his rights and responsibilities. If those rules and regulations regarding agents, given in the *Fiqh* literature on the *Mudaraba* are followed, the moral hazard problem to a large extent can be controlled, if not eliminated.

Thirdly, the moral hazard problem arises because of non-observability and the violation of Islamic *Shari 'ah*. Under non-observability, the fixed return or fixed wage turns out to be optimal. I would like to add a correction that even if it is observable, sometimes the actions of the manager are observable, but they are not verifiable. So, the important thing is not non-observability. The important thing is nonverifiability. They can observe that he is cheating. They know that he is not making the right efforts. The manager is not doing his duty. However, they cannot verify it, they cannot prove it in court. In the literature, this is discussed as observability versus verifiability. So the important constraint is verifiability.

The second correction that I would like to make is that whether the fixed wage contract or profit-sharing contract is optional depends on the risk attitude of the agent and the principle. If both shareholders and managers are risk neutral, then the profit-sharing contract turns out to be optimal. This is the

reference that I was quoting in response to Dr. Hameed that in case both of them are neutral towards risk, then the profit-sharing contract turns to an incentive.

### **A Participant**

I have a query about the equilibrium of the firm which has not been mentioned here. We have discussed the moral functional economy but what about the equilibrium of the firm. Under circumstances, can a firm reach equilibrium in the Islamic economic framework. Secondly, modern economics uses terms for conventional production organizations, such as partnership business, cooperative system and monetary joint stock company. In the Islamic economic system we have terms, such as *Musharika*, *Murabaha* and others. Can we being to use these Islamic terms? Are they accepted by modern economists?

### **Dr. Iqbal**

As far as the equilibrium of the firm is concerned as far as I can see, even in Islamic economy, estimation costs are equal to marginal revenue. So they will try to do this, if they are maximizing the profit, and I said that they can. I said that profit maximization is a genuine objective to follow. It is one objective, it is not the only one. But if that is the case, then the equilibrium will be to marginal revenue, and equally to marginal cost. If they have other objectives in their production function, they will derive the first order condition and get it under the Islamic framework. Is it sufficient to define it in this way?

The important thing is the objective function. If in the objective function there is only profit, you maximize the objective function. If your objective function has only one argument which is profit, then the equilibrium of the firm will be marginal revenue equal to marginal cost. If you have another argument in the objective function you will take those in the long run. Technology is astral whether it is Islamic or non-Islamic. If you want to produce *Zakah*, *you will* use technology; you will use the same technique.

How do you know whether or not we have improved technique of the firm? The question is the technique which is called maximization or optimization. You apply that technique to a different objective function and you get different results. Secondly, you had another question, as to whether we should give the names *Murabaha* and *Musharika* or partnership. Well, as far I am concerned, I like to give currency to Islamic terminology. If we try to use

Islamic terminology then people will follow and will try to learn it. The Israeli Parliament is called the Knesset, and they use the word Knesset and now everybody knows 'what it means. So why should we be shy in using Islamic terminology? We should use that terminology. In many cases there are not exact equivalents in modern terminology, e.g., *Murabaha* has not exact equivalent in modern terminology. Why should we use other terminology?

Let me turn now to the objective of the firm. The maximization objective is neutral. But what is the objective function? This is where Islamic firms differ from non-Islamic firms. You see the objective function should be derived from Islamic values. For examples the objective function concerns the number of those employed or the sales or supplies of basic commodities. Later we can maximize this. We maximize the labor we employ and the commodities we supply in order to get better profit?

### **A Participant**

Excuse me brother. I have two questions. First, under the Islamic system what is the optimum size to which a firm can grow? Secondly, is the vertical or horizontal integration of a firm as prevails in the modern economic system permitted in the Islamic system.

### **Dr. Iqbal**

As far as integration is concerned, there is nothing that Islam prohibits except profiteering monopolies. If integration goes to such an extent that the firm intends to have a monopoly either full or partial then this is prohibited, because it is very undesirable. However, some monopolies, which are in the government sector, are permitted to the extent that the integration does not go out of the way to give monopoly power to the firm. Secondly, regarding the size of the firm, this is again the same principle of the firm which is applied in the secular economy. I do not find that there is any problem here. The only difficulty is if the firm becomes so large that it has, not a pure monopoly, but substantial market power, as we say. If it has substantial market power, then it may be against *Maslahah* and against antitrust laws. Even in the secular economy, there are antitrust laws. So if the size of the firm becomes so large that it has substantial market power, then it has to be curbed.

This also comes under the maximum size or optimum size of the firm. Efficiency is promoted by the Islamic principle that if it is efficient to have a larger size company, then it is permitted.

#### **A Participant**

You have said that technology is neutral with different economic systems. Is that true?

#### **Dr. Iqbal**

You must remember the context of technology that we are discussing. The word is techniques, i.e., how do we make this cup or mathematical techniques such as  $2+2 = 4$ .  $2+2 = 4$  in an Islamic economy and  $2 + 2 = 4$  in a non-Islamic economy. These kinds of formulae, these kinds of mathematical techniques, are neutral. We were talking about maximization which is a technique. Maximization is a tool. It is a simple, mechanical application. When you formulate an objective function, you apply that function and in the formulation function there are differences. But in the application of the techniques, there are no differences. If you have any kind of labor-intensive technology versus capital-intensive technology, we are talking of something different. So, let me have your question and I will respond to it.

I mean that if you have some fundamental degree of spoil in technology, then possibly the technique might not be the same.

I meant tools of techniques that is why I gave you the example. I think that  $2 + 2 = 4$  in Bangladesh. At least hope so.

I do agree with that meaning of technology. If you talk about labor-intensive, the location and condition of the country has to be taken into consideration. What we were talking about was the problem of technique, such as,  $2 + 2 = 4$  or maximization or calculus of integration. These kinds of regression analysis, etc.

Under the Islamic economic framework, are there two conditions that must be satisfied in respect to profit?

The answer is that these two conditions do not relate only to profit. These conditions, the first order condition and the second order condition, relate

to any objective function. You want to ensure an interior solution and depend on the convexity or concavity of the function itself and the same two conditions will be there. The only difference will apply to an objective function which has a different argument. If the objective function has only profit as an argument, then the two conditions will also turn out to be the same. But if the objective function is different, the first order and second order conditions will also be different.

I would like to make a comment. There are some firms which have a monopoly. We get together in an Islamic discussion, they sometimes take offense. They feel that there should be some sort of monopoly in an Islamic economy especially what is known as national monopoly. How can we deal with that? It is not merely competition.

I can only say that, yes, I agree that there are certain kinds of monopoly which exist. There is national monopoly sometimes it is possible to have monopoly in the public sector. However, the guiding principle, as both myself and Dr. Abdul Rahim mentioned, is ultimately that the *Maslahah* and the *A hukabra*, have to decide what is the *Maslahah* in a particular situation and then that should prevail.

#### **The Chairman**

If there are no more questions, I would like to thank our lecturer, Dr. Munawar Iqbal, and the floor for your cooperation. Thank you.

***CHAPTER SIXTEEN***

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# DISTRIBUTION IN ISLAM

Sayyid Tahir \*

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My proposed topic for this seminar is Distributive Justice from Islamic Point of View. Distribution always involves some give and take on the part of both parties in an exchange process. Coincidence of the perceptions of givers and takers is next to impossible. This makes the notion of distributive justice a slippery concept. Therefore, we propose to shift the discussion from a philosophical to a practical plane, and take up the more general topic Islamic Viewpoint on Distribution Or Distribution In Islam.

At the outset, we also propose to remind our colleagues that the Islamic position on economic inequalities is not to defend them. On the contrary, Islam stands for eliminating injustices. Distribution is simply one important part of the Islamic scheme for eliminating injustice in the economic domain. Insha' Allah our discussion will support this conclusion.

Allah is al Hakeem. All His actions have some *hikmah*. We shall begin our discussion by making a modest attempt in Part I to see the wisdom behind Islam's distribution scheme. This shall be followed in part II by noting the Islamic injunctions on distribution. As it turns out, Islam offers the most comprehensive approach to distribution. The distribution issue is addressed at the following levels:

1. Opportunity level - preproduction stage
2. Productive activity level:

A) Distribution among those directly contributing to production process

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## B) Redistribution among the nonparticipating poor and destitutes

3. Post-production level, through guaranteeing fulfillment of Shari 'ahjustified minimum needs
4. Redistribution on a yearly basis
5. Redistribution at the intergenerational level

There is also a support mechanism to ensure that the system produces the desired results. All the above measures are also backed up by an elaborate informal redistribution mechanism. This discussion is followed in part III by a blueprint of the Islamic model of distribution and a note on analytical literature on the distribution subject produced in the eighties.

## I. OBJECTIVES OF THE ISLAMIC DISTRIBUTION SCHEME'

According to the Islamic world view, life in this world is a test. Primarily economic and other inequalities, to the extent that they are natural, are facets of this test. This follows from the first part of the 165th Ayah of Surah al An' am:

Message: And, it is Allah Who made you Khalifah of the earth and placed some of you better than others. This is in order to test you in the blessings He bestowed upon you.

There are three general objectives of the Islamic teachings on distribution, which follow from the Qur'an:

### 1. ESTABLISHMENT OF A VIABLE ECONOMIC SYSTEM

Consider the middle part of the 32nd Ayah of Surah Zukhruf:

Message: We (i.e., Allah) apportion livelihood among the mankind in the life of this world. And, We raise some people above others in rank. These differentials in livelihood and ranks are intended to enable people to take work from one another.

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1 This section draws heavily on Mufti Muhammad Shafie's *Islam ka Nizame Taqseeme Daulat* (Translated as *DISTRIBUTION OF WEALTH IN ISLAM* by Muhammad Hasan Askari Karrar Hussain), Begum Aisaha Bawany *Waqf*, Karachi, Pakistan. The urdu text is followed here.

The following conclusion may be read between the lines: The primary objective of the Islamic distribution scheme is to support an economic system which is both natural and practicable. It ought to be such that everyone has incentive to put in his best effort. Of course, "everyone" includes all contributors to production process, whether employers or employees.

## **2. Guaranteeing Everyone his Rightful Due**

Producers should get their due and factors of productions theirs, however defined'. This point is well taken by Muslims and non-Muslims alike. The institutional and legal setups of all organized societies accommodate this point. Of course, any difference can be attributed to what one views as just. Islam goes one step further. Life is viewed as a mutual affair. Producers, and (by implication) other factors of production, owe their respective positions to other members of the economy, who may not have directly participated in the production process. The poor and the destitute specially deserve reciprocity in this regard. Islam elevates them to the status of secondary owners in the production process for all practical purposes. Allah has enshrined their rights along with those of other participants in the production process in the Islamic distribution scheme. See, for example, the middle of the 141st Ayah in Sura al An'am

وَأْتُوا حَقَّهُ يَوْمَ حَصَادِهِ

Message: And give the right of crop when it is harvested.

Similarly, 24th and 25th *Ayat* of Surah al Ma'arij:

(وَالَّذِينَ فِي أَمْوَالِهِمْ حَقٌّ مَعْلُومٌ لِلْسَّائِلِ وَالْمَحْرُومِ)

Message: And, persons belonging to Allah are those in whose property there is a definite right for those who ask for it and those who have need for it.

## **3. Eradication of the Concentration Of Wealth**

It is possible that a fair and honest working of the system may still lead to growing gaps between the haves and the have-nots. The implications of such a possibility have already been experienced by humanity, for example, in the form of infidelity and communism. Thus there is a need for some additional

safeguards. This general principle of eradication of concentration of wealth (or, keeping economic inequalities within tolerable limits) stems from this part of 7th *Ayah* in Surah al Hashar:

Message: What Allah has bestowed upon His Prophet Muhammad (Pbuh) in the form of *fay* belongs to Allah, the relatives of the Prophet, orphans, the needy and the wayfarer. These guidelines are prescribed in order to ensure that the proceeds of *fay* do not circulate among the wealthy only.

Fay is perhaps the simplest conceivable way of acquiring any thing from others, except of course gifts and charity. The generalizations to all other matters is straightforward.

## **II. ISLAMIC INJUNCTIONS ON DISTRIBUTION**

At the outset, we should note that absolute ownership belongs to Allah alone. Islam does recognize private property rights in acquisition and disposition of *halal* things. But on the disposition side, there are some restrictions. The *zakah* portion is to be dispensed in the manner prescribed in *Shari'ah*. Practically it is the share of others whom we referred to as secondary owners in fruits of one's effort. Islamic injunctions on distribution may be classified as follows:

### **1. Injunctions at the Opportunity or Preproduction Level**

Everyone has an equal right of access to primary sources of production and wealth as follows:

- i) Natural pastures and grass that grows by itself
- ii) Natural forests and all that they consist of
- iii) Sea, lakes and rivers and their produce
- iv) Undeveloped lands and mines
- v) Bounty of war
- vi) Any other primary means of production, like i-v

Everybody can benefit from these resources according to his ability and effort.

## **2. Injunctions at the Production Level regarding Participants in the Production Process**

The following general guidelines are to be observed in respect of productive activities.

- i) When one party hires labor services, skilled or unskilled, the wage rate ought to be determined in advance though payment may fall due at the end of the working period, not necessarily the production period.
- ii) Financial resources may change hands in any one of the following three forms:
  - a) *Qard* (or, *grade hasan*), whereby the lender has right to the principal only
  - b) *Mudharabah*
  - c) *Musharkah*

In case of *Mudharabah* and *musharkah* contracts, the profit-sharing ratios must be predetermined. The principle of "no interest" is to be strictly followed.

- iii) All nonhuman material resources may change hands in the following manner:
  - a) Fungible (or perishable) resources may be acquired on market prices
  - b) All other resources which by and large remain intact (besides, of course, normal wear and tear) in the production process may be hired on the basis of a predetermined rental, where the rental is the market price of the services involved.
- iv) The status of a producer's entrepreneurial efforts would be similar to that of financial resources, though not necessarily at par with the latter.

- a) Valuation of the fruits of productive efforts (i.e., determination of commodity or services prices) ought to take place via a fairplay of market forces.
- b ) Determination of all other rates and profit-sharing ratios should take place by a fairplay of their respective market forces, subject to any other conditions mentioned above.

The roots of the aforementioned injunctions can be traced to the Qur'an and *Sunnah*. Important *fiqhi* principles in this regard are: al Kharaj bid Daman (income only with risk of loss) and al Ghunum bil Ghunum (income risk-bearing).

### **3. Injunctions at the Production Level for Redistribution among the Secondary Owners in the Production Process**

Khums', *ushr* and *zakah* on the outcome associated with the current production process. --- This fits with the notion of Allah-ordained secondary ownership rights mentioned above.

### **4. Injunctions not related to the Production Process but aimed at Reinforcing the Redistribution Process, as above**

- i) *Nafagate wajibah*: Rights of relatives (parents, spouses, children and near relatives).
- ii) Khums' on economic gains accruing in the current period in the form of *ghanimah*, treasures and troves.
- iii) Injunctions supporting the fulfillment of *Shari'ah* justified minimum needs<sup>2</sup> --- This point may also be classified under points 5, 7 and 8 below.

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2 See "Guarantee of a Minimum Level of Living in an Islamic State" .by Mohammad Nejatullah Siddiqi in M. Iqbal (ed.) DISTRIBUTIVE JUSTICE AND NEED FULFILLMENT IN AN ISLAMIC ECONOMY (published by International Institute of Islamic Economics, Islamabad).

## **5. Injunctions on Redistribution on a Yearly Basis**

*Zakah* on wealth which is, by definition, output carried over from the past.

## **6. Injunctions for Intergenerational Level Redistribution** The

Islamic Law of Inheritance

## **7. Injunctions on Redistribution based on Public Interest**

*Masaleh Mursalah* or *Istehsan* support the following:

- i) Taxes and transfers
- ii) Asset redistribution

## **8. Injunctions on Voluntary Redistribution**

During all periods of the Islamic history, Islamic teachings on *infaq* consistently resulted in voluntary redistribution in the following forms:

- i) Voluntary *nafaqat* in general
- ii) Rights of neighbors
- iii) *Waqf*

For additional measures, refer to "Islamic Redistributive Schemes" by Anas Zarka in M. Iqbal (ed.) *DISTRIBUTIVE JUSTICE AND NEED FULFILLMENT IN AN ISLAMIC ECONOMY* (Published by International Institute of Islamic Economics, Islamabad, 1987).

## **Enforcement Mechanism**

As noted in the beginning, the beauty of Islam is that it not only prescribes a system, but also provides an enforcement mechanism for the Divine teachings. The salient points may be listed as follows:

1. Institutions

**Nonformal Institutions**

- A. Family
- B. Neighborhood
- C. Masjid

**Formal Institutions**

- A. Market mechanism
- B. *Zakah* (on a self-financing basis)
- C. Baitul Mal
- D. Profit & Loss Sharing-based financial intermediation
- E. *Hisba*
- F. *Qadaa'*
- G. *Waqf*

2. **Legal Backup**

- i) Jihad against the nonpayment of *zakah*
- ii) Economic activities which are injurious to the individuals' personal interests and which promote economic injustice, are simply banned. For example, wine-making, gambling and interest.
  - a) All contracts are to be recorded.
  - b) If a contract involves an element of ambiguity leading to an alteration in the natural risk distribution, it is invalid -- neither negotiable nor enforceable.
  - c) *Shari 'ah*-inconsistent contracts are automatically invalid and carry no claims. For example, interest-based loan contracts.

3. **Safeguards against nonbeneficial redistribution**

The institution of shufab.

To recapitulate, let us note the following points:

- i) In Islam the idea of economic justice is not left to the vagaries of democratic and other sociological processes. It is Divinely ordained.

- ii) Islam emphasizes redistribution along with distribution.
- iii) By elevating the redistributive activities to the level of *ibadah*, their negative side effects on efficiency are avoided.
- iv) Islam's distribution scheme ensures greater economic security via the institution of *zakah*, *sadaqat* and *nafaqat*. This, in turn, is likely to promote risk taking and spur economic activity.
- v) The Islamic scheme is likely to ensure a better circulation of the fruits of economic activity across all socioeconomic classes and sections of society.
- vi) Islam weeds out sources of economic injustice and inequality, for example, through the elimination of interest and gambling.
- vii) Islam provides a multi-stage corrective mechanism to contain economic inequalities which may threaten economic stability.

Last, but not the least, the interests of all economic agents are **safeguarded**. With these observations, let us next **take a** brief look at the modeling side.

### III. MODELING THE ISLAMIC VIEWS ON DISTRIBUTION

Islam emphasizes redistribution along with distribution. This point offers interesting possibilities from a modeling point of view. Formally, the Islamic model can be viewed as a three-tier model as follows:

Block'A': Distribution of the value of outcome associated with the current production process:

1. Formal model of "Functional Distribution of Income" among participants (or, primary claimants) in the production process:

Wages:	To be determined by the interaction of market forces of supply of and demand for labor, with emphasis on ' <i>adl</i> and <i>ehsan</i> .
Rent:	To be determined by the relevant forces of demand and supply.



- Profit:
- i) Price of product to be determined in its market
  - ii) Cost of inputs to be determined in light of their market prices and employment levels
  - iii) Total profits (= revenues - costs) to be shared among producers and financiers in market-determined profit-sharing ratios

2. Formal model of personal/family/household income distribution incorporating the functional distribution of income, as above, and the redistribution of income among the secondary claimants on the outcome of the production process..

Block 'B': Intertemporal distribution and redistribution of wealth.

Block 'C': Intergenerational redistribution of wealth through a well-defined inheritance mechanism.

### **State of the Art**

Distribution has been a favorite topic of Islamic scholars in this century. Several rigorous and less rigorous studies on this subject are available. We shall list only the works of an analytical significance produced in the 1980s according to their contents. this will give us a rough idea of current thinking in the area.

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  - Mohammad Fahim Khan (1984) "Classification of Factors of Production in Islam" - Unpublished paper of Factors Centre for Research in Islamic Economics, King Abdul Aziz University, Jeddah.
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2. Some studies also discuss formal modeling along microeconomics lines; their focus is on factor pricing. Besides the works by Ahmad Mustafa and Hossein Askari and A.H. Mohammad Sadeq cited above, there is one more reference.
  - Syed Abdul Hamid Al Junaid (1987) "Factors of Production and Factor Pricing from an Islamic Perspective" Paper read at the International Seminar on Islamic Economics for University Teachers held in Islamabad during August 22-September 3, 1987,

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3. The following works explore distribution in a macroeconomic perspective, along the Kaldor-Pasinetti lines

- Ausaf Ahmad (1988) "A Macro Model of Distribution in an Islamic Economy"
- Mabid Ali Al-Jarhi (1988) "Towards an Islamic Macro Model of Distribution:

A Comparative Approach"

Both these are published in Fahim Khan (ed.) DISTRIBUTION IN MACROECONOMIC FRAMEWORK: AN ISLAMIC PERSPECTIVE. One may also wish to refer to Journal of Research in Islamic Economics for a discussion on these two papers.

Anybody planning serious work in this area should also consult Mufti Muhammad Shafie's seminal work. It is a masterpiece both in terms of cogent thinking and substantial points.

***TER SEVENTEEN***

## CHARACTERISTICS OF MARKET BEHAVIOR IN ISLAM

*Mahmood Anas Al-Zarqa\**

### **Comment and Question: Dr. Munawar Iqbal**

One of the most important differences between the **approaches** of economists and jurists which the speaker has not commented on and which has very important implications for Islamic economics is the combination of economics and *Fiqh*. The main concern of jurists is with the legal rights and responsibilities of the parties of a contract. Basically, they are jurists because they explain laws, whereas the economists' main concern is in explaining economic behavior. The interest of jurists is not in explaining economic behavior. However, once that behavior falls into a contract between two parties, then jurists are concerned with the rights and responsibilities of the parties, whereas the major concern of economists is to explain the economic behavior of various economic agents, i.e., a traders, buyers, sellers, consumers and producers. Do you agree?

### **Dr. Zarqa**

I agree, Dr. Munawar Iqbal, that perhaps I should have put this as the first difference. Actually, I pointed to it briefly under the question: Is this comparison valid? So, really the first difference is that economists have a positive approach whereas jurists approach all material from the point of view of what is right and what is wrong. If jurists are concerned with cause, economists want to know what the consequences of various things are and what are the causes effects relationships ? However, I would say that it may not be clear in the pure economic competition model which represents the standard economic model. The *Fuqaha* have their own standard model of the market which I pointed out. The difference is very clear. However, when we go to new

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market structures which economists have studied and which the *Fuqaha* have not, (because basically *Fiqh* stopped developing in the sixth century), we have a gap of eight hundred years between what the *Fuqaha* have addressed themselves to normatively and what economists have addressed themselves to positively. Some types of market structures have persisted throughout history. There is a certain common area, but when you come, for example, to bilateral monopoly or all kinds of incomplete competition, such as, monopolistic competition or other forms of market structures, you find that the jurist is completely silent because when *Fiqh* was developing, these structures were not in evidence. Now we must address ourselves to these new market structures. When we try to do so, we find that we have to read a lot of economics and a lot of the rules of *Fiqh*. The normative rules of *Fiqh* about these new market structures will be very much affected by what economists say about their actual consequence. So the clear division between the *Fiqh* and economics will be much more narrow when you come to new market structures. The *Shari'ah* rules about them are not exclusive; you have to derive them. In deriving them, you have to build the *Shari'ah* rules on the potential consequences of various market structures. This is positive economics; you have to navigate somewhere in the middle between *fiqh* and economics.

### **Comment and Question**

I have a comment about the compulsion between economists and the *Fuqaha* or *Shari'ah* people on these transactions. Economists realize that there is a cost for the transactions, but for simplicity's sake only, they assume that this is in the long run. So when we take this static analysis, we ignore the cost of these transactions. However, if we go to dynamic analysis, it is necessary that there is an economic reality, that there is an individual as well as a social cost for any transaction. Economists are, however, careless about these because they believe that in the long run, people by taking their own interests into account would realize that they have to take their minimum cost and the market will clear in subsistence type of cost in the long run.

### **Dr. Zarqa**

I agree. I do not mean to say that economists do not appreciate the existence of the social cost. They have usually ignored, but now, a lot of modern literature is addressing itself to the consequences of the existence of such a cost.

### **Comment and Question**

In economic transactions or financial transactions, there are payments on the basis of cash transactions and credit transactions. Credit transactions depend upon the trust and confidence of the two parties in the transaction, and this absolutely depends upon the rules of the *Shari'ah*. This aspect was not mentioned in your speech. Can you please clarify it ?

### **Dr. Zarqa**

In fact, credit transactions by their very nature involve at least the delivery of the goods and later the delivery of the price of the goods in one way or the other. Consequently, the cost potentiality in transactions is higher in a credit transaction. It is not only the cash aspect of the transaction cost, it is also a matter of the credit involved and the time that is spent. For instance the possibility of default or of not carrying out the full obligation and the potentiality for something happening so that one party can not fulfill one's obligations is greater the more time that is spent. So the transaction cost will go up by necessity and the rules of the *Shari'ah* related to the fulfilling of contracts become all the more important. Would you agree with me that when we have a credit transaction, that the transaction cost by necessity will go up because the arrangement of credit is a costly matter? Also, finishing or implementing a contract that involves credit, not the exchanging of goods or money directly but by credit, multiplies the possibility of various kinds of non-fulfillment. So, when a feel that it is a transaction is taking place on credit, we see the importance of these various rules magnified many times. The rules of the *Shari'ah* about transaction become even more important in a credit situation.

### **Comment and Question**

Please differentiate between the characteristics of the marketing of goods and the holding of goods from an Islamic point of view.

### **Answer**

If I understand the question correctly, you are asking whether the *Shari'ah* makes a distinction between someone who engages in trade on a more or less daily basis buying and selling goods and someone else who engages in trade in a less competitive market. He buys goods and may sell them two years later. So he holds the goods for some time.

Now, you see, here is the question of what we call *Ihtikar*. *Ihtikar* commonly translated as monopoly, but this is not a very good translation. *Ihtikar* in *Fiqh* means to hold goods - to buy goods at one time, hold them and to sell them later. There are certain points about the holding of goods which we know do serve useful purposes in economics. You can, for example, buy mangoes when they are in abundance and hold them until they are scarce. You are doing yourself some good and society some good as well, because this is a useful activity. However, there are other ways of holding goods which become a basic cause of creating a supply crisis. If the goods itself is an essential one, such as, basic food or salt, then this is the bad aspect of holding. So the *Shari'ah*, in this case, differentiates between holding goods which have a beneficial social consequence and holding which have a bad social consequence. At the time when the traditional *Fiqh* developed in the fifth and sixth centuries of Hijra, the *Fiqh* was very clear on this matter as most of the holding of goods at that time was a merchant activity. Now we have more subtle ways of holding supplies. These have not been addressed fully and satisfactorily by modern *Fiqh*, because we Muslim economists have not done our work of presenting them in a way the *Fuqaha* understand, in the form of the consequences of these new types of market behavior. This is an open question. However, I would say in essence that the *Shari'ah* does not prevent a person from buying goods and holding them and selling them later. Essentially this is permissible. It is only not permissible when the goods themselves are staple goods, such as, basic foodstuff and when holding them helps to increase the price. Of course, the price may increase in any case, but the question is whether or not the price increase is adverse. If we can show that it is harmful, the *Shari'ah* would be very much against it.

### **Comment and Question**

Could you please explain the causes behind price hikes and the necessary measures to overcome them ?

### **Dr. Zarqa**

This question raises an important point, but it does not, I feel, belong in this particular lecture. However, I will try to answer it briefly. What guidelines can we provide in understanding the causes behind price hikes and the necessary means to overcome them? There are economists who have paid a lot of attention to the matter of price phenomena. Price hikes are like fevers or temperatures; they have hundreds of causes. Economists have studied these systematically



and they have identified most of them within the market structure. Is it a monopolistic structure or pure competition? What kind of market structure do you have? After they have identified this, they go on to distinguish between the forces affecting supply or affecting demand and then they look for a particular time plan, and then they ask what sources were behind for a particular price movement and so on. Sometimes the price hike is very healthy and beneficial, because it is the only way to get a greater supply in the future. Sometimes, it is useful from a social point of view when you have a rather rigid supply because social hindrances will not permit the supply to increase. In this case the price increase only transfers income from buyers to sellers. In other situations, the price hike is very healthy and useful. So really, we have to study economics because economists are the people who answer such questions and sometimes unsuccessfully, but at least they try.

### **Comment and Question**

Regarding the acknowledgment of the individualistic market, social role and exchange, you give the example of a person who comes to a contract for selling and buying commodities or goods in the market. There is one buyer and the seller sells a good at a higher price than is actually in the market. The *Fiqh* is of the opinion that the contract should be nullified because it is an overcharge. It is, of course, an overcharge, but the buyer was free to know the price, to have a knowledge of the price in the market. I have said that you might have the contract when the market was noncompetitive that is the conditions for ideal pricing mere missing. Take the transport cost as an example in this case. if differences or overcharges are not very large, in that case the contract should not be nullified. Thus, in the *Shari'ah* it should be the case that overcharge must have a limitation. What is your comment on this ? Do you understand the question ?

### **Dr. Zarqa**

I understand your question. You were probably rightly surprised at the ruling that if a person is overcharged for a good, that all sources of *Fiqh* say that mere overcharging alone does not cause a contract to be nullified unless there is some other violation committed by the seller. Now this requires elaboration. Let me give an example of the violation that the *fiqh* considers to be a cause for nullification when these violations are combined with overcharging. One form of it, as you have just mentioned, is if the seller is a monopolist. However, monopoly in the *Fiqh* sense is not the monopoly in the economic sense. In the

economic sense, a man can be a monopolist in the sense that he may be the only seller in the country who has the right to sell a certain brand or type but this is an instance of a nonessential good. *Fiqh* does not agree with this. He is a monopolist, but this monopoly may be tolerated. We do not care much about it. However, if a seller is a monopolist in the *Fiqh* sense of having a monopoly of a staple good, then overcharging becomes nullifiable. Also, if the seller is engaged in untruthful advertising. So if I came to him and asked what the usual price is then I have been overcharged since I asked him to tell me the usual price. I am a buyer who does not know the market price and who is asking the seller to please sell at the usual price. If this is the situation and he overcharges me then this is a cause for nullification. But if none of this took place and it was only a case of overcharging, then the *Fiqh* says that I have committed a mistake. I must bear the cost the overcharge. However, monopoly in the *Shari'ah* sense is a cause to nullify the contract if there is overcharging. If I am a monopolist and I also overcharge, then you can nullify my contract.

### **Comment and Question**

How does exchange in Islamic *Fiqh* ensure justice in the distribution of income and wealth ?

### **Dr. Zarqa**

I will limit myself to very briefly comparing justice in exchange with justice in the distribution of income. In a sense, the *Fiqh* is very clear that justice in exchange is achieved when exchange takes place at the prevailing market price. Suppose that there is a market where transactions are made in general according to the *Shari'ah* rules. In a market in which the overall structure is relatively competitive, we, in Islam adopt what an economist like Baumal calls congestive market. It is not purely competitive, but it is workably competitive. . If people through their voluntary exchange in this market come to express their preferences and if the supply condition in the market is competitive, then you get a market price. That market price is a criterion of justice in exchange for the goods transacted, as far as exchange is concerned.

So far as income and wealth are concerned, you find that the *Fiqh* in terms of exchange accepts that the market price is given and whenever they need to go beyond consent they go to the market price. They do not go to what the Christian scholars in Middle ages called "just price", is a price that covers cost of production. The *Fiqh* never placed any particular value on anything called a

just price in the scholastic sense, which is the term used by some other authorities. The *Fiqh* at all times goes to the market experts and asks what is the price and its equivalent. This is their standard. Therefore, in a sense the *Fiqh* accepts the market price without modification as a criterion for justice. Is this attitude of noninterference the same when it comes to the distribution of income and wealth ? The question can be asked as to whether in market transactions the *Shari'ah* accepts the functional distribution of income and wealth as given with no interference. The answer is, "no". If you study the *Shari'ah* rules about the distribution of income and wealth, you will find that there are many measures to affect and modify the distribution of income and wealth which resulted from valid market transactions. Therefore, I think that the position of the *Shari'ah* on the distribution of income and wealth is very clearly based on intervention, whereas the *Shari'ah* position on justice at the individual transaction level is based on noninterference.

In income and wealth the *Shari'ah* does not accept the resulting distribution as being taken as given. Instead it implements numerous institutional measures to modify that distribution. Therefore, my concluding remark is that the *Shari'ah* did not use the same criterion of justice in market exchange and in income distribution. In the market, the *Shari'ah* looks, at the consequences of market transactions, more or less as given, as long as these transaction are carried out within the overall limit of the *Shari'ah*. But even though people are engaged in one hundred percent valid transactions, the *Shari'ah* does not take for granted the result with regard to income distribution. The *Shari'ah* modifies that income distribution by *Zakah*, by inheritance and by all the obligations that it places on the wealthy to help the less wealthy. In numerous ways the *Shari'ah* have modified distribution. These ways of modifying distribution are not based on the premise that the market transactions were invalid. They were valid for the two parties involved. However, one may question why this difference exists and how the *Shari'ah* can accept the market price which may distribution that it later changes and modifies ? Why? I think the answer probably is that in market transactions, justice is basically concerned with the two parties. Since we know that the distribution of income and wealth affects all society not merely the two parties in an exchange there is, therefore, nothing surprising in taking one attitude on the issue of exchange and another attitude on the issue of distribution. The basic idea is that on the issue of exchange, the *Shari'ah* more or less takes the view of noninterference in while it adopts a policy of interference on the issue of income and wealth distribution.

## Comment and Question

I must begin by thanking Professor Anas Al Zarka for his very hard work and his explanation of the major principles governing transaction and exchange in Islamic law. However, I have certain observations which I would like to make clear. First of all, there is a very common saying that the *Fiqh* stopped in the sixth century. I believe this must be corrected. Our *Fiqh* has not stopped at all until this day. The *Fiqh* can not stop because the activities in Muslim society are progressing and the *Fiqh* whether as jurists rulings or judges' decisions have to meet these challenges and to answer them. We know that Ibn Taymiyah and other important people lived after the sixth century. They introduced certain new ideas and called attention to the stopping of the legal implications of the Islamic *Shari'ah*. Therefore, the *Fuqaha* found themselves out of the function or unable to do their work. So I believe that this claim that *the Fuqaha* did not do their job after the sixth century must be reviewed again and viewed within the function of the *Fiqh*. The judges were able to seek guidance from other Muslim countries and were even able to select from the best legal thinking in the world. It is very important that this be recognized.

Second, according to certain opinions in the Hanafi school, if the seller overcharges the value of the articles, then the purchaser has the option to nullify the contract. These are the two observations which I would like to make.

**Dr. Zarqa**

I will not really challenge the first comment. When I said that the *Fuqaha* by the sixth century probably decided to close the door of *Ijtihad*, the market situations that the *fiqh* addressed were essentially those mentioned by *the Fuqaha* of the sixth century earlier. New market situations were not addressed. Take the question of industrial monopoly. Those monopolies discussed by the *Fuqaha* are basically of the commercial type. Suppose that there is a weak harvest of some staple food. I am a big merchant and I go and buy large quantities of the staple good to drive the price up by withholding supplies. Then I start selling little by little. This is a commercial monopoly. However, let us suppose that I am the only cement producer in a country. My monopoly is of a different type. I do not go and buy cement from the market. I simply reduce the supply because I have control of capacity and I can reduce and increase supply as I like. Now this type of monopoly, whether legitimate or not, has not been discussed in the *Fiqh*. I am saying that the *Fiqh* principles themselves do not permit such reduction of supply; but it requires a new *Ijtihad*.

It requires fresh insight. If you take into consideration new market structures, such as, monopolistic competition, you find that the *Fiqh* is silent because there were no Muslim economists who studied it. I acknowledge that there were many outstanding personalities who lived after the sixth century, but somehow the issue was not discussed systematically in the earlier *Fiqh*. When you look at the forms of relationships mentioned in classical *Fiqh* books, you find that all of them started since then. The remaining generations elaborated rather than drew attention to new forms.

As far as the second observation, you know that the civil law of the Ottoman empire was derived from the Hanafi school only. Now they put such limits for what is considered overcharging but still the position of the Hanafis and the other schools on overcharging without any further violation is that *Shari'ah* rules will not permit the nullification of the contract. However, if there is some other violation, the contract may be nullified, you find that overcharging only, i.e., an increase above the market price is vague and does not justify. It needs certain limitation. They say real estate twelve percent is considered overcharging, in mobile things it is 5% whatever they have said there are limits. Then you see that there are two questions before you nullify a contract: to establish that overcharge has taken place. The other, is there some other violation beyond overcharging.

### **Comment and Question**

It seems that presently jurists, economists and *Shari'ah* specialists are living in different worlds. Jurists deal with something legal economists are concerned as to whether something is profitable or not or whether something gives us more employment or economic support. Actually we do not deliberate the question of what is wrong or what is right, but economics tells us that value judgment should not be made. You have made an interesting point about exchange. You said that if there is a lot of mangoes in Bangladesh, the fruit should be sold just as it ripens. Now what actually happens in our case. In the Rajshahi area there are a lot of mangoes and there are people who live by selling mangoes, and among these there are some rich people as well as some very poor people.

I will give you one example. There is one person who has a mango tree on which the mangoes are still small. If he sells now, he will get a small amount of money, say for instance, one thousand taka. However, if he keeps the mangoes until they are ripe, he might sell them for twenty thousand taka or for

nothing because of natural hazards. So a poor person cannot take a risk. He normally shifts the risk to the richer person. He sells the mangoes at one thousand taka and he is satisfied. There are also some neutral persons who buy and sell mangoes at different stages from the flowering to the ripened stage for two or three thousand taka. So why this wrong ? The poor person cannot bear the risk; he wants to shift this risk to some other person. Why is this not justified from *Shari'ah* point of view?

**Dr. Zarqa**

I do not have sufficient details, but I can appreciate the general direction of your comments. My reaction is the following. If we study in detail any particular market transaction, the *Shari'ah* has a lot of new ways of dealing with the matter, but they require interference from the social authority. For example, you find the question of people being too poor to bear any risk or to wait for a little time in order to gain a lot of potential income. However, because they are too poor, they can not wait for it. This is definitely a problem of income distribution more than market transaction. It is very difficult to interfere, and sometimes interference brings the opposite results. I cannot give a general judgment, but I know some countries where out of concern for the poor farmer, the social authority is engaged in extensive interference and I have seen that as a result of such interference, poor farmers are left underpaid. They are underpaid by public authorities who are forced to cope with all kinds of other problems that eat up whatever supplies are to be transferred to the farmer. So social interference is not always good. I think the problem is the fact that the people are poor. Their problem is more related to income distribution than to exchange itself.

#### **Comment and Question**

What is the position of the *Shari'ah* in so far as a minor entering into a contract is concerned ? If the minor acquires equity through stock companies, does such a contract remain valid ?

**Dr. Zarqa**

I do not have the exact *Shari'ah* answer on this point. We know that a transaction by a minor is distinguished by whether he has permission to engage in the transaction from his guardian. So if the minor has permission, then he can certainly enter into certain transactions. If this permission is not given and if the

state of being a minor is obvious, the contract can be nullified. But if his being a minor is not obvious to the other party if it is concealed or if the other party does not consider this person to be a minor, then there are all kinds of factors involved, and, quite frankly, I do not know the details of this *Shari'ah* rule. However, in principle, there is a lot of flexibility.

I do not think that the only possible answer is that if a minor engages in a transaction through a joint stock company, then this somehow is frozen until he attains his majority. I think this may be very harmful to the company itself. I do not think this is the only possibility discounted by the *Fiqh*. In general, there is hardly anything unreasonable which the *Shari'ah* requires you to do. Most things which you feel to be unreasonable, you can be certain 90 percent of the time that they are not permitted. In the *Shari'ah* special transactions are based on basic common sense and the feeling of justice. I can assure you that something which is obviously unreasonable to a lot of sensible people would hardly be permissible in the *Shari'ah*.

**PART IV**

**PRIVATE AND PUBLIC FINANCE  
AND  
FISCAL POLICY IN ISLAM**



***CHAPTER EIGHTEEN***

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# PUBLIC FINANCE AND FISCAL POLICY IN ISLAM

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***Monzer Kahf\****

## INTRODUCTION

To understand Public Finance in Islamic perspective, we will have to look into the concept of the State within the Islamic framework. As it is defined by Muslim scholars, a state is the political entity responsible for the collective affairs of the Muslim community both in this worldly life and in the hereafter. Consequently, the items of expenditure as well as revenues should fulfill two criteria. First, to serve the best interests of the members of the Muslim community, and second, to be regulated within a framework compatible with the Divine revelation.

At the early Islamic era, the Muslim community in Makkah did not have a political entity. It was part of the Makkan society. Soon after a good number of people accepted this new religion<sup>n</sup> and due to persecution, the Prophet (Pbuh) started searching for a place or land where religion could be let free to grow, Muslims can be governed by *Shari'ah* (the Islamic law), and they can be saved from the consistent persecution inflicted upon them.

While he sent some of his companions to seek refuge in Ethiopia where they could freely practice their rituals, he kept searching for a place in the Arabia where he could establish an Islamic system in a real social life.

He thought of Taif, Bahrain and other areas in the Arabia before discussing the issue with the Madinah people. The migration to Madinah was a landmark, because it marked the beginning of the Islamic state and the

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emergence of an Islamic society ruled by the Divine revelation. This may be why 'Umar made this migration the beginning of the Islamic date.

One of the first things the Prophet (Pbuh) did in Madinah was to lay down a constitutional framework that determines the rule, of government and relationships between different religious and ethnic communities living within the state. This written constitutional document is, perhaps, the first written constitution in the world. It recognizes two types of public expenditure, one for the defence and military objective, and the second for the welfare objective. For military expenditure, this document suggested that the Muslims would provide for their own arms and equipments in case of any military attack on the state, and the Jews would provide for their own arms and equipments in the collective defence of the city state.

On the other hand, the main welfare item mentioned in this constitutional document were helping those who were under debt and freeing the captives. These two needs were to be provided for on the basis of small ethnic communities whereby each neighborhood would provide sufficient resources to meet this responsibility.

Interesting enough, this document anticipate certain public expenditure needed for the management of the society, but it did not provide for imposing any taxes.

In the rest of this paper, we will discuss the public revenues and expenditures of the Islamic state during its early time which covers the period beginning with the Hijrah until the end of the four Caliph, i. e., about 40 years. This period is the period of the Prophet (Pbuh) and the Companions; it is usually considered by Muslim jurists as the most rich period of application and inspiration of Islamic values and system. We will also discuss the main characteristics of public finance in this period. This will make Section I.

The Second section of the paper will relate the principles of public finance derived from the Madinah era to the contemporary life of an Islamic state and will discuss these principles within a practical framework of a contemporary Muslim society.

## SECTION I

### **A HISTORICAL SURVEY OF PUBLIC REVENUES AND EXPENDITURES DURING THE ERA OF THE PROPHET (PBUH) AND HIS FOUR SUCCESSORS CALIPHS).**

Upon his arrival in Madinah, the Prophet (Pbuh) started looking after the financial needs of the society and securing revenues to meet these needs. We have many sayings and reports about how public expenditures were met. Some state's guests would come from out of town. They need to be sheltered and fed. They were usually sheltered in the Mosque or a tent put by the Mosque, but they were fed by voluntary contributions from able people.

Additionally, the first expenditure met by the Prophet (Pbuh) in Madinah was constructing the Mosque as this was one of the first thing he did. The Prophet (Pbuh) paid 600 or 800 Dirham for the land. The owners of the land wanted to volunteer it, but the Prophet (Pbuh) refused and insisted on payment using "voluntary contribution from Abu Bakr. Even the trip of (*hijrah*) itself was financed by voluntary contributions from Abu Bakr as authentic reports say.

Hence, voluntary contribution was the major source for paying for these kinds of public expenses. These included: hospitality of guests coming from other areas, social welfare payments, such as, debts of deceased persons and feeding the poor and hungry, and defence expenses; all these needs were met by voluntary contributions. When the Battle of Badr came in the second year of *hijrah*, some war booties were taken from the enemy; and distributed among the fighters. Surah Eight in the Qur'an, Surah al Anfal, describes the way this were to be distributed. Part of the income may be given to the Head of State to use for public interests and four-fifths of it were distributed to the fighters.

There were cases and reports that at the beginning of this period the Prophet (Pbuh) did not take much welfare responsibilities. For instance, if a person died leaving unpaid debts, he would refuse to perform funeral prayers on him saying: will you make funeral prayers on him as I don't want to pray on him because he had unpaid debts.

We have an interesting report from Abu Hurayrah. It says: that attitude of the Prophet (Pbuh) continued in the first few years of *hijrah*; but when the state became rich after the conquest of Khaybar which was a rich agricultural

land with a variety of products, the Prophet (Pbuh) made a new decree, or a new announcement, that whoever dies, leaving either dependents who need support or unpaid debts, the government would carry the load. However, if he/she leaves wealth or estate, it is to be distributed to his/her family according to the law of inheritance. This means that before the state became rich, it did not take responsibility of unpaid debts of deceased persons and it took that responsibility only when resources became available.

The early resources came ..(easy?); as one man died in the Battle of Uhud. He was a Jew, who fought with the Muslims in that battle and urged his tribesmen to do the same in fulfillment of an outstanding agreement with the Prophet Muhammad. Before he the man made a last will that should he die, then his seven orchards he had in Madinah should be given to the Prophet (Pbuh). These seven palm tree orchards made the first source of income of the Islamic state. It is reported that the Prophet (Pbuh) used the revenue of these seven orchards for expenses of his family, and for buying weapons and armored cloths for the fighters.

Shortly after the conquest of the Khaybar, the Prophet (Pbuh) made a very interesting arrangement. He considered one half of the land as a property of the *Ummah* and kept the farmers, on their request, on the basis of output sharing<sup>2</sup>. This marked the first appearance of *Kharaj* in Islam. It is manifested in the arrangement made by the Prophet (Pbuh) with the land users, who were in Khaybar that they may stay in that land, cultivate it and give half of the produce to the owner of the land who are now the Muslim (*Ummah*) as represented by its government.

This role of *Kharaj* was expanded in application during the time of 'Umar when lands of Iraq, Syria, Egypt and Persia were opened in the years 11 to 22 of *hijrah*.

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1 There are reports that the companions were unable to have their stomach full before Khaybar was conquered.

2 Some reports say that all of the land was left as property of the *umamah*, but according to Abu Ubaid Ibn Sallam, who made a detailed study and analysis considering the various reports, only one half of the land was made a property of the *umamah* and put under the authority of the state to derive revenue from. The ownership of the other half was distributed among the fighters, but was actually left in the hands of the farmers under the same condition of output sharing.

Most of these lands were opened by war and the conqueror took over the land according to the then existing international standards. 'Umar did not distribute this land and kept all of it owned by the *Ummah* to be a source of revenue for the government. This *Kharaj* became tremendous during that period. The *Kharaj* is, therefore, only a rent of the land, or the share of the landowner in its produce. Many reports confirm this kind of arrangement. For instance, once a person bought a *Kharaj* land, and 'Umar asked: Is it a *Kharaj* land ? How could you buy it ? From whom did you buy it ? From the owner, the man said. How did you know who was the owner ? I don't know, but I thought' it from a man who had a hold on it.. 'Umar then said: he is not the owner; and then 'Umar called for prayers and when people came for prayers, 'Umar told that man that these were the owner ! Did you buy it from them ? Definitely not ! Then return it, the land cannot be yours and get your money back; this land is owned by the whole *Ummah* and the person who holds it has only a right to cultivate it on rental basis. Upon conquering the land and making it a property of the *Ummah*, 'Umar sent land surveyors to measure the land and determine the rent according to the kinds of products. He fixed a *Kharaj* (rent) for each lot of land.

About two hundred years later, Abu Yusuf, the famous scholar, said to the *Caliph*, then Harun al Rashid that **you** may use one of two methods in determining this *Kharaj* or this rent. You may make it as a rent per acreage, or you may take it as a share of the products. You take 20%,30% or whatever you may decide provided you leave to the farmer a share sufficient for decent living and working on the land for the following years.

This is the *Kharaj*, a rent on the land that is owned by the *Ummah* or by the state as a representative of the *Ummah*. It is a rent, not a tax or levy on privately owned lands. Since the time of the Prophet (Pbuh) and during all the times later, *Kharaj* was never applied to land that was not conquered. For instance, the lands of Madinah and Makkah, never had any *Kharaj* imposed on them. By the same token, *Kharaj* was never imposed on those several pocket areas where people turned into Islam on their own, i. e. without. There were many pockets of that kind in those countries and you will find many reports in the *fiqh* books of that time that say the land between this river and that river or between these mountains or called so and so, this is not a *Kharaj* land, because its inhabitants have already turned into Islam before the whole country was opened. Look, for instance, in the book of Abu Ubaid, *al Amwal*, and the book of Ibn Zanjaweh, under the same title *al Amwal*.

## **The Public Expenditure during this Period**

In a way of examples we have expenditure items, such as, spending on guests coming from overseas, supporting the poor and needy, payments of debts of people who could not pay their debts, construction of mosques, starting with the mosque of the Prophet (Pbuh) in Madinah, and later on its expansion and the expansion of the mosque in Makkah around the Ka'bah. Until Makkah was opened or conquered in the year of 8 of *hijrah*, there was no report that there were paid employees, at least no reports available that there were employees paid by the state. There were people working for the state but on voluntary basis. Said bin al 'as who was a children teacher, probably full time teacher was one of the *Muhajirs* from Makkah, but apparently he had his own income that he did not take any income from the government for teaching children. There were reports of other assignment given to some people but there were no reports available that the government paid salaries until Makkah was conquered. The Prophet (Pbuh) appointed a Governor of Makkah - 'Attab bin Usayd - and assigned him a salary. Probably, this is the first salary given by the government in Islam.

However, as the government developed and expanded, Abu Bakr was assigned a salary. The moment he took office as *Khalifah*, a salary was assigned to him; salary was also assigned to Umar when he became the second *Khalifah*. At the time of Umar, there was a long list of salaried employees. Judges, policemen, night guard or night police, there were people who estimated and collected *Kharaj*, governors of different provinces of the country; all these were assigned salaries during Umar's time. The public administration became a new and big item of expenditure, in- addition to a full time paid army that was maintained by 'Umar. Before him, the army was not on a full-time basis.

There were other items related to public administration and welfare expenses. For instance, Umar expanded welfare payments to men, women and children, he bought a house in Makkah and converted it into a prison, he assigned people to take care of certain plots of land he kept for the state out of the conquered land, he also appropriated lands for grazing for the cattle collected as *zakah*, he established a regular guards for such lands, and created messenger services between Madinah and major cities in all provinces, etc.

## **Public Revenues during this Period**

During the life of the Prophet (Pbuh), one may notice that the first source of public revenues was voluntary contribution of people. This item of revenue represented the major source in the first few years of the Islamic state in Madinah where the Prophet (Pbuh) used to call for contributions whenever there was a need for public spending.

The second and most important source of public revenue was war booties resulting from the battle of Badr. Most of these revenues were disposed of as soon as since they were acquired, mainly by direct distribution to the fighters.

The third item was the return coming from public property acquired as a result of the last will of the above mentioned Jew and expanded later on when Khaybar was opened. The last but not the least was the *zakah* proceeds. *Zakah* was made obligatory by Allah in the second *hijrah* year. It was appreciated for specific categories of expenditure mostly of welfare type.

## **General Characteristics of Public Finance during this Period**

What are the main characteristics related to the public expenditure and revenues during this period ? And, what are the general principles of public finance that can be derived from this forty years of experience of the Islamic state ? This can be briefly presented in the following fourteen points:

1. The first point that characterizes the public revenues of that period is the formation of social or public capital, i. e. a capital assigned to the state, not to be used or expended itself but to become a source of public revenue. Obviously, land was, at that time, the major kind of income producing capital, so land was designated to the state in order to create a source of income for the treasury (*bait al mal*).
2. The second point is consolidating the concept of property right of every citizen and protecting private ownership even when it comes in front of the state. It has been well established that the government has no right to infringe on the private property and was never permitted even to take a tax, let alone confiscation or nationalization of any private property.



3. The third point is that *zakah* is the only duty on individuals whose only reason is being rich, i. e. there is no other financial obligation on a rich person simply because he/ she is rich or simply because he/ she owns more than *nisab* except *zakah*. All and any other revenues were voluntary during that period and the Qur'an is full of verses urging persons to give voluntary contribution for the sake of Allah. No financial duty was imposed on any person, rich or poor, during the whole period of the first Islamic state in Madinah. This does not mean that a rich person is free from financial responsibility in Islam. Take for instance, the concept of expanded family. A rich person in a family is responsible for poor members in the expanded family if it is within his or her means. This responsibility is derived from family relationship, not from the incidence of having wealth. Throughout that period, there was no taxes although all governments around the Islamic states imposed many kinds of taxes. However, Muslim scholars later discussed the issue of tax and you find it unanimous among them, that only if there is a public pressing need, the government may impose taxes.
4. Public borrowing had started from that period as early as the Prophet's (Pbuh) time. He had made use of public borrowing. It is said that when he died, he was under debt of forty thousand (40,000) dirham. It was paid to creditors after his death. This loan must have been made for the use of the government, because forty thousand dirham was too much to be used by person of the Prophet (Pbuh) and his family.

There were other reports that he had borrowed several times from Umar and from some other companions. At one time, he borrowed some weapons from a non-Muslim. Thus, resorting to public borrowing was well practiced during that period. Interestingly, the Prophet (Pbuh) took public loans, but did not impose taxes. To avoid taxation, he also used other means. He collected *zakah* in advance when he had pressing needs for expenditure. At least one report is clear about this. The Prophet (Pbuh) took *zakah* from al Abbas two years in advance; probably there may have been other cases too.

5. On the other hand, during the time of Umar, the government delayed the collection of *zakah* when there was famine in the area of

Madinah and its vicinity, and in the following year double (*zakah*) dues were collected. This means that *zakah* has a flexibility to allow for being used as a tool of fiscal policy, by delaying it or by collecting it in advance, probably for even more than one year. If you can collect it in advance for one year, you may also collect it for three years. Some Muslim scholars in the 60's suggested the collection of past due *zakah* for five or ten years and its distribution to the poor as a means of wealth redistribution and an alternative to nationalization.

The next point is that there was heavy dependence on private initiative even in cultivating the land that was owned by the state. The conquered land of Khaybar was all given to private individuals for farming. There are several reports of land distribution by the Prophet (Pbuh) for the purpose of farming and grazing. There are also reports that the Prophet (Pbuh) encouraged his companions to be active in trade, craftsmanship and other productive activities. All these indicate that the economic philosophy of the state was based on promoting private initiative and considering it the main source of economic prosperity for the individual as well as for the society as a whole.

7. Restricting the role of the state to promoting and encouraging the private sector as much as possible. This may be derived from that famous report by Abu Hurayrah that the Prophet (Pbuh) helped a private citizen to reprocess his durable consumer goods (a rug and a pitcher) by selling them to buy productive goods (an axe); and helped him to plan for cutting woods from the mountain (hill or forest) and selling them to earn his livelihood.

Moreover, self-reliance production philosophy goes further to the extent that the Prophet (Pbuh) refused to give charity to a person who can earn his livelihood, although at the moment the person was not working, in order to induce him to productive work and he proposed eating out of one's own hand's earning. The *zakah* which is a form of financial worship (*'ibadah bi al Mal*) can only be practiced if 'the person is a rich individual to pay it; and preferring to giving charity the Prophet (Pbuh) said: "the upper hand is better and more beloved to God than lower hand".

8. There was also emphasis on the principle of voluntary contribution to finance the government activities. I call this voluntary contribution the principle of democratization of the government, in contrast with the principle of sovereignty of the government imposing in tax levying. Perhaps taxes should be levied on the basis of offering projects, as the Prophet (Pbuh) did. He offered projects that needed financing. If people accept financing these projects, it means a public approval of the projects. If people do not approve financing the projects, they would have to be thrown away because people don't want them. This is the democratization of the public expenditure.
9. Linking public revenues to public expenditures. There are certain kinds of public revenues that have specific usages, i. e. the government has to use them only for certain kinds of expenditure. An obvious example is *zakah* since it can only be used for those eight categories of expenditures mentioned in the Qur'an, in Surah No. Nine. Another example is what is called *fay'* which is booties obtained from the enemy without war. Also its distribution is mentioned in Surah No. 59. Here again, you are limited in distribution to the five categories mentioned in the Qur'an 59:7. Those kinds of revenues must only be distributed to certain heads of expenditure and nothing else.

Additionally, voluntary contributions solicited for certain projects or activities can only be used for that purpose, or that project like the Prophet (Pbuh) did.

Let us go one step further, if you want to impose certain taxes on the ground that there was not enough revenues. The rule has been established that you can only justify a new tax by the need for its proceeds on the expenditure side. This is what I mean by linking revenues to expenditures.

Hence this link does not necessarily mean budget balance because there may be public borrowing which means that revenues and expenditures were not balanced. Moreover, during 'Umar's time, there was surplus in the *bait al mal*. Surplus was used in the following year. Also, delaying the collection of *zakah* or collecting it in advance mean there was no balancing on a yearly basis.

10. During this period, the functional priorities of the society were made clear that first of all comes establishment of religion, justice and sustenance of the poor are next in line, then implementing the Islamic law in all its branches, then comes the other things, such as, taking care of the material welfare of human beings. The principle of justice was specifically applied regardless of national, ethnic, geographical, color or religious affiliation; it was also applied to Muslims and non-Muslims, alike.
11. It is noticed that throughout this period, there was no government budget in the sense known today as a tabulation of expected revenues and anticipated expenditures. In the life time of the Prophet (Pbuh), he used to dispose of any revenue that came to him as soon as possible. It is reported that once, immediately after finishing one of the daily prayers, he walked away hurriedly crossing the lines to his home which was adjacent to the mosque. The companions were surprised and when he came out, they asked him whether there was any problem and he said that during the prayer he remembered that there were few dirhams still undistributed and that he wanted to take them out for immediate distribution.

However, during the rule of Umar, the second *Khalifah*, records of revenues and expenditures were initiated. *Kharaj* land started to be surveyed and their rent calculated in advance and expenditures were tabulated by their nature in different registers called 'Diwan'. In spite of these records, we do not have any report that a comprehensive listing of revenues and expenditures was ever maintained. Consequently, the concept of government budget is a new one, but it is consistent with the Islamic teachings related to public finance.

12. Throughout this period, one would notice that the different provinces of the Islamic state maintained financial autonomy to a reasonable extent. Firstly, *zakah* is considered localized by many *fuqaha*'. Localization of *zakah* means that whatever is collected within a province or even a smaller segment of it, would be distributed within the same area of collection. This may be supported by Umar's disliking of bringing to the central government part of the *zakah* proceeds in the province of Yemen by its governor - Mu'adh. Mu'adh's explanation was that he could not distribute locally all the

proceeds as he did not find sufficient number of people to accept to take it, and he was only bringing the surplus of the *zakah* of the province".

More over, provincial governments were the final decision-makers with regard to the heads of expenditure in their provinces although they were subject to central control, inspection and accountability as practiced beginning from the era of 'Umar (see for instance, the book on *Umar ibn al Khattab* by Mohammed Sulaiman al Tamawi, Cairo, 1967).

On the other hand, the central government in Madinah had little revenues of its own, i. e. except for *zakah* and *ushr* that have their own categories of recipients, the central government did not have resources or revenues. Therefore, it was dependent on the surplus of *kharaj* that used to be sent from the northern provinces of Syria, Iraq, Persia and Egypt where most of the land was *a kharaj* land. These central revenues were used mainly for maintaining the huge army recruited throughout the Arabia and usually dispatched from the capital, Al Madinah, and for welfare expenditures which was clearly manifested during the famous famine year in the time of 'Umar that was called 'the year of Ramadah'.

13. During the time of 'Umar, a new rule was introduced in international trade relations of the Islamic states. He was informed by governors of some frontier provinces. that other countries were charging Muslim merchants who entered their lands certain taxes to the amount of 10% of the value of the merchandise. After consulting with some companions and provincial governors, Umar dictated that the Islamic government should also charge merchants coming from those countries a similar tax on the basis of reciprocity. To implement this tax on foreign merchandise, Umar appointed tax collectors and placed them at entrances, bridges and main roads connecting the Muslim land with neighboring countries.

However, while applying this reciprocity principle in public finance, 'Umar noticed that some products were domestically needed and to encourage foreign merchandise to bring these goods he reduced the taxes imposed on desired imports to 5%. It should be noticed,

however, that the real incidence of this tax on domestic buyers of imported commodities was not really investigated during that time.

14. Public funds and assets were looked at as sanctioned and, to some extent, sacred. The Qur'an talks about their protection from any theft or mishandling (Qur'an 3:161). During the time of the Prophet, several people were appointed as treasury keepers or public treasury keepers. Bilal was one of them. He used to keep revenues in a safe place and distributed them in accordance with the instructions of the Prophet (Pbuh). Some times public revenues were kept in the Prophet's (Pbuh) house.

Since the time of Abu Bakr, a special place was kept for the revenues of the state, but since the time of Umar, a special department of *bait al Mal* (house of funds) was erected and Umar appointed official treasurers to keep *bait al Mal*.

Public funds were categorically distinguished from the private assets of the *Khalifas* or the rulers. Both Abu Bakr and Umar were assigned salaries and they were not mixing their private funds with those of *bait al Mal*. When Usman took over, he did not accept to take any salary from the state treasury as he himself was rich.

## SECTION II

To derive a theory of public finance out of these principle is not an easy task. Yet these principles of public finance represent the main outlines of our contemporary understanding of public revenues, public expenditures, public debt and budgeting from Islamic perspectives. In this section, we will focus on public revenues since expenditures are discussed under the functions of the Islamic state in another paper. We will also discuss the size of government and fiscal policy in the Islamic economic system.

### A) PUBLIC REVENUES IN ISLAMIC PERSPECTIVES

Any attempt to formulate a theory of public revenues in Islam or to conceive a structure for these revenues ought to depend on the understanding of the public revenues model of the early Islamic period. The discussion in the first three sections of this study provide the bottomile of this section. The main lessons of the previous sections related to the public sector's revenues, taxation and private sector's financing of the government.

#### I) Revenues from the Public Sector

The principle of ownership in Islam warrants the expansion of the state's non-tax revenues.

The ownership system legislated by Islam is based on the existence of private ownership that is protected and secured side by side with public ownership that is also protected and secured. The Islamic economic and financial systems are based on this inter-marriage between public and private ownerships. Islam has accorded the state with the ownership of an extensive portion of the country's economic wealth. Public property includes the land that is not utilized in economic production, mineral resources and the sources of energy such as cataracts and waterfalls<sup>3</sup>. Moreover, the responsibility of the state to provide public utilities such as roads, potable water, etc., and to invest its properties and the surplus of the economic public sector for the benefit of

3 Kahf, Monzer, *"The Economic Public Sector and its Role in Generating Revenues for Development in an Islamic Economy"*, paper presented in the seminar on "Financial Resources of the State in Modern Society from an Islamic Perspective", organized by the Islamic Research and Training Institute (IRTI) in Cairo, April 1986. Proceedings of this Seminar are edited by Monzer Kahf and published by IRTI, Jeddah 1990.

society warrant the expansion of the public sector and public ownership to an extent that may be larger than what is witnessed in many western countries today<sup>4</sup>. Establishing fixed assets that yield non-tax revenues to the state was a basic component of the financial policy during the Prophet's and Caliphs' periods. Today, building up public property as a permanent base of revenue for the public treasury is not confined to agricultural land as it becomes possible to extend it to other types of investment, including monetary investments in many cases. In the Islamic system, the sources of ownership of the economic public sector are:

- 1) Allocation of resources by virtue of the system itself
- 2) Investment of the surplus of public property,
- 3) Utilization of the yield of the war booties, *jizyah*, tithe of trade with non-Muslim foreign countries and
- 4) Borrowing from the private sector.

Confiscation of private property is not one of the public sectors' sources as Islam has emphasized the sanctity and inviolability of private ownership. In addition, during the Prophet's and Caliphs' periods, public property was not established through imposing taxes on the people to transfer savings from the private to the public sector. That taxes and confiscation are not a source for mobilizing resources for the public sector does not mean a low profile of the economic public sector, since what is allocated for it in terms of public properties makes it occupy a significant part of the economic activities in any contemporary society.

The Islamic state can price its public sector's products according to what it deems appropriate, in order to achieve its aspired economic objectives<sup>5</sup>. The state can also use price discrimination between the public sector's products, categories of consumers or provinces and geographical regions, as a tool for realizing the objectives of its economic policy. In this regard, four points arise:

1. By analogy with the regulations related to *him*, barren land and the common properties of the community, the state is not entitled to

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4 *Ibid.*, pp.37-38 and 49-50.

5 It may be noted that the government can use the size of production and employment in the economic public sector as a tool of economic policy as well. The state can also change the size of production of a certain commodity to attain the same objective.



favor the rich with certain privileges and the same for the poor, although the contrary is permissible. Consequently, the idea of encouraging investment through injecting savings of poor sectors (agriculture and animal husbandry) into a rich sector (industry) by means of taxation and pricing, etc. may raise a big question mark in Islamic economics.

2. Many of the services that are customarily considered as free of charge by socialist standards may not necessarily be so in the Islamic standards. Education and medical care may be provided by the Islamic government when sufficient revenues from the economic public sector are available. Otherwise, providing education to the youngsters is the parents' responsibility, so is health service which is part of the *shari'ah* dictated household expenses as detailed in Islamic jurisprudence. We should take into consideration that the poor are given *zakah* as due to them up to their sufficiency. If *zakah* is not sufficient, dues on the wealth of the rich will ensure the minimum required for the living of the poor. It is possible then that neither education nor health services may be offered free of charge to the rich in Islamic system. As for the poor, *zakah* fund may offer them what they need for spending on education and health.
3. Establishing and maintaining public services such as roads, public drinking places and mosques are the responsibility of the Islamic government if it has non-tax revenues from state properties and economic public sector<sup>6</sup>. If the government does not have sufficient revenues, then it can impose fair fees on the utilization of some of these services .
4. Some public properties are considered in *shari'ah* as community property, especially those referred to in the Prophet's saying - pasture, water, fire and salt. It may be difficult to charge this type of public goods a price that is more than the production cost in case the technological and demographical development warrants that their utilization or procurement require big capital investment such as in

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<sup>6</sup> Al Ahkam Al Sultaniyah, p.245.

<sup>7</sup> Such as for using a road for which there is an alternative for people to use however difficult, and a drinking place that can be dispensed even with tolerable hardship. As for a road for which there is no substitute or a, as a place of worship mosque, it is not permissible to impose a fee for using either of them. Al Ahkam Al Sultaniyah, p.p. 245-246.

the case of salt extracting, packaging and distribution. If the price exceeds the cost of production of these goods, this would be a constriction of people's right of finders keepers<sup>8</sup>.

Finally, *kharaj* of the economic public sector is a financial revenue that is characterized with more flexibility than *zakah*. The Islamic government can increase or decrease *kharaj* according to its policy. Methods of levying and collection are flexible too. Awile'Umar imposed *kharaj* as a specific amount to be levied on the area of land, Abou Yusuf proposed the modification of assessment to be a percentage of output, saying: "I have found nothing more trouble-saving for *bait al mal* and for *kharaj* people than reaching a compromise.... a sharing formula that would satisfy the ruler and endow *kharaj* people with peace of mind and favor"<sup>9</sup>.

The Islamic state can also use the proceeds of the economic public sector, *kharaj* for anything that would fulfill the public interest where as in *zakah* we find that its proceeds are restricted to the eight heads of expenditure as mentioned in the *Qur'an*.

## II) Taxation

*Zakah*, the basic pillar of the Islamic financial system, is the only financial obligation in the Islamic economic system which a Muslim should pay because he owns wealth/ income that exceeds a prescribed exemption limit called *nisab*. It is the sole obligation imposed on owing wealth and/ or having income. This does not, however, mean that there are no other financial obligations. Spending on relatives, entertaining of guests, satisfying the needs of the poor and the needy, and tithe on the trade of those who are at war with Muslims as well as other financial obligations known in the Islamic system, but they are imposed on the ground of other reasons, namely, relations' needs, guests' entertainment, the needs of the poor and the needy and the introduction of merchandise of those who are at war with Muslims into Muslims' territory, etc. Similarly, the availability of means and the security of the journey. are considered conditions for the performance of hajj<sup>10</sup>.

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8. At the same time it is against *Shariah* to permit some individuals to install investing equipment on these natural resources that would enable them to get more than any other individual can get out of them.
  9. Abou Yousuf, p.p. 49-56.
  10. *Faqh al-Zakah*, pp.988-992, especially the last four paragraphs.

Contemporary economic and financial systems refer to various purposes of taxation, especially meeting public expenditure required for the production of public goods' <sup>11</sup>. This represents the most important part of the allocative role of taxes which is related to allocating economic resources between the production of public goods and that of private goods. Taxes have another allocative role, i.e. between the different private goods themselves. As for the other objectives of taxation they include distribution, stability, equilibrium and development<sup>12</sup>. The question persistently asked in this respect is: what is the status of taxes in the Islamic financial system? Are there any constraints on imposing taxes or on their use to fulfill the said objectives?

To answer this question, opinions of classical Muslim scholars should be studied but there is no scope of doing so in this paper <sup>13</sup>. The following conclusions would emerge from the presentation made in this as well as other papers <sup>14</sup>, and the review of the opinions of some classical scholars.

1. It is impermissible to impose tax on wealth/income only because it is owned/accrued, or on the rich because of their wealth and/or income. This would mean that the purpose of transferring private savings to the public sector does not, alone, allow the imposing of tax in the Islamic financing system.

This may also imply that tax levy to reduce the income (or wealth) of the rich, on the claim that the present size of income (or wealth) increases demand which may lead to inflationary pressure is not acceptable in the Islamic financial system. For even if it is determined that such a harmful pressure on prices should be avoided,

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11. R.A. Musgrave and P.B. Musgrave, Public Finance in Theory and Practice, 4th ed. (Mcgraw-Mill, New York, 1984), p.p. 48-54.
  12. Monzer Kahf "Towards a Theory of Taxation in Islamic Economics", paper presented in the seminar on Financial Policy and Development Planning in Islam held at the International Institute of Islamic Economics, the International Islamic University, Islamabad, July 1986 (pp. 3-7), see also papers by Fazlul Rahman Fandi, Abdin Salamah, Muhammed Mukhtar Mutwalli, and Musgrave and Musgrave.
  13. For details please refer to: Abdul Salam Abbadi Ownership in Islamic Shari'ah, AI-Aqssa Publishing, Amman, 1975, vol.2, pp.288-301, and Fiqh Al Zakah, pp. 990-992 and 1093-1105.
  14. See the papers mentioned in Note (91) and Monzer Kahf "Taxation Policy in an Islamic Economy" in Fiscal Policy and Resource Allocation, edited by Ziauddin Ahmad, Munawar Iqbal and Muhammad Fahim Khan, publisher: The International Center for Research in Islamic Economic, Jeddah 1983, pp. 131-153.

the size of damage does not justify the confiscation or seizure of private savings in the name of taxes to attain price stabilization for two reasons: i) There are other alternatives to reducing income which attain the same purpose, namely, reduction of government demand, absorbing part of individual income through public borrowing and using monetary instruments to reduce demand, etc. and ii) Such damage - if it is rationally proved - does not justify such a levy, rather it may call only for putting restraint thereon.

2. Those *fugaha* who approve of taxation link this matter with necessity. They interpreted the non-existence of taxes in the early period of the Islamic state by lack of necessity, in view of the abundance of other sources. Such understanding of taxes implies two conclusions: a) Tax levy is the last resort in the Islamic Financial System. It must be preceded by many moves especially manipulation of the *kharaj* of the economic public sector, collection and spending of *zakah*, selling what can be sold of public goods and services to the buyers or users at a suitable price, financing what can be financed of public projects especially those of developmental nature through equity (participation) by the private sector on the basis of *Musharakah* or *Mudharabah* according to *shari'ah*, voluntary or compulsory public borrowing and donations to the public treasury, etc.<sup>15</sup> . b) Expenditures for the sake of which taxes are imposed should be examined and what is unnecessary among them should be omitted. It is worthy of note that necessity is determined according to *shari'ah's* criteria and tax should not be imposed to meet excessive expenditure or that which is not permitted by *shari'ah*. This requires that tax imposition should be closely linked with public spending, and with the duties the state assumes in the Islamic system. A differentiation should be, however, made between what a state has to do in all circumstances, and what it should do provided non-tax revenues were available.<sup>16</sup> For example, in case *zakah* proceeds are insufficient to satisfy the minimum needs of the poor, and lack of non-tax revenues, it is permissible to impose taxes to meet those minimum needs (line of poverty).

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15. Monzer Kahf "Towards a Theory of Taxation in Islamic Economics", pp.35-38.

16. Ibid., pp. 8-14 and 33-35.

The principle of solidarity among members of the Muslim society may constitute a strong base for tax imposition - when imposed." We noticed how the Prophet (Pbuh) applied this principle on blood money and prisoners' ransoms in the constitutional document he issued on his arrival in Madinah<sup>18</sup> It should be noticed, however, that blood money and ransom are part of the indispensable and essential expenditure.

4. Finally, it is worthy of note that Muslim scholars emphasize that the tax burden should be divided among the "*able people*", i.e., the rich. Justice and social solidarity call for progressive tax imposition on the rich<sup>19</sup> and not on the poor. As such, it seems likely that some kinds of taxes may be objectionable from *shari'ah* point of view. For instance, indirect taxes intended to collect large revenue, which are imposed on goods or services consumed by a large sector of the people, may burden the poor and the rich alike. Besides, customs duties may sometimes be regressive in their incidence<sup>20</sup>.

In addition, financing, through borrowing from the central bank as a kind of public revenue may raise an objection from *Shari'ah* point of view since it does not comply with "making the rich assume in burden of taxes". Financing through new issuance of money, if it leads to inflation and currency devaluation is in fact some sort of tax on the wealth and income of people whose wealth and income are determined in money units. This also loads the poor with unfair burden in contradiction with Islamic principle.

### III) Private Sector's Financing of Public Expenditures

The private sector could participate in financing public expenditures in three ways: partnership, lending or donation. There are no instances of partnership financing in the early period of the Islamic State although it might be preferred to lending because of its expected return.

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17. Ibid., p. 1083.

18. Systems of Government in *Shari'ah* and History, p.33.

19. A saying (tradition) that " a dirham has outdone a thousand dirhams" refers to the importance of alms burden in getting reward which indicates that in tax levying the tax burden should be taken into account.

20. "Towards a Taxation Theory" ... p.39.

1. Participation of the private sector in financing public expenditures may take several forms of which the most common is equity participation in profitable projects undertaken by the public economic sector. This participation may be on *Musharakahhh* or *Mudharabah* basis.

Mute public infrastructures can be financed by the private sector, where the private sector may construct and sell or lease such projects to the state or construct - them on behalf of the state based on a contractual relationship which may realize a reasonable profit. The treasury may pay the installments from the normal revenues over a number of years.

The idea of private sector participation could be expanded further to include the financing of ordinary current expenses through identifying a number of public services' sectors, such as operating an airport or running the school system in a given year in a given city, where such services - once specified in details - can be contracted to the private sector.

Thus participation of the private sector - on the basis of profit provides a viable alternative to domestic interest-based public borrowing. Such participation may reduce the deficit in the ordinary or development budgets to an extend that might push the entire financial and economic system to a greater degree of democracy, where the government's economic power - whether in terms of its ownership of productive capacity, or in terms of its being the biggest employer - would be distributed and owned more and more by individuals.

Regarding the *shari'ah-related* problems that might result from the financing and ownership of companies contracting with the government, such as the problem of prohibiting bond's negotiability except in the nominal value of the debt. Such a problem could be solved by identifying components of the assets of such companies in such a way as to make debts not constitute the major ingredients and where the increase of debts on the government on the company's assets side will be considered a sign of weakness and inability to get new contracts. So the more debts appearing on the company's assets side, the closer it is to being liquidated and, therefore, the more

restrictions should be imposed on transacting its shares. A ceiling could also be put to the number of shares that an individual may own in this type of companies in order to preclude concentration on such shares in a limited number of hands.

2. Interest-free public borrowing could also be resorted to sometimes, especially mandatory borrowing. An example of such borrowing could be taken from *Sunnah*, where money was borrowed from rich people and monetary obligations (such as *zakah* were collected before their due date. Such obligatory borrowing is known nowadays in some systems<sup>21</sup>. However, the most important form of public borrowing is borrowing from the financial and banking sector (including the central bank).
3. Finally, donations cannot be overlooked as one of the sources of public revenues of contemporary Muslim countries. Such donations increase with the increase of solidarity and harmony between the government and its people. It is to be noted that one of the important forms of contemporary donations is that in which some of the services and constructions (such as street beautification and public parks) are left to the private sector to undertake on the basis of donations. Such works may be a form of advertising private sector's companies.

## **B) THE SIZE OF GOVERNMENT IN THE ISLAMIC SYSTEM**

Does the Islamic ideology call for a big or small government ?

It would not be easy to give an answer to this question, because it depends not only on the ideological foundation of the Islamic econo-political system, but also on the resources available to a Muslim country as well as the economic and political specific circumstances of that country.

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21. For example the U.S. Government provides for payment of installments of income tax during the fiscal *year* to the treasury. But, normally, the total sum of installments withheld exceeds the amount of taxes due, a matter that necessitates the refunding the individuals of such excess amounts after the end of the *year*. The excess often amounts to tens of billions of U.S. dollars.

However, from a theoretical point of view we may look at two aspects, namely, resources theoretically made available to the Islamic government and the functions of the Islamic state.

From the point of view of the theoretical structure of public resources in an Islamic state, we have noticed earlier that the Islamic economic system accommodates public ownership of natural resources side by side with the private ownership. We also noticed that the Islamic system does not permit private ownership of minerals, water resources lands appropriated as a source of public revenues and similar natural resources. Consequently, from this point of view, the Islamic econo-political system assigns more revenues (coming out of public property) to the government.

On the other hand, taxes are not considered a privilege of the government and we have seen that there are restrictions on tax levying power of the government at least more than what we find in the capitalist system. This implies less accessibility by the government to privately owned property as a source of public revenues.

On the other hand, from the point of view of functions of the Islamic state, we notice that these functions are always determined in terms of available resources. Consequently, whenever there are revenues resulting from public property, the Islamic state is required to expand its services to its people and take up many functions that would not be taken had it have to depend on tax revenues.

Additionally, it should be noticed that the Islamic system assigns more responsibility to the state than one may notice in secularist systems. As we have seen earlier, the Islamic government is not only responsible for the material welfare of people, it is also responsible for their spiritual welfare, i. e. it is charged with the task of promoting the welfare of its people in the hereafter. In fact, providing guidance, explanations, promotion of the cause of religion and support to those who take its path, is a task of an Islamic state with regard to all humanity, let alone the Islamic state's own people.

Therefore, more religious functions are given to the government in the Islamic system while the functions of education, public service and similar things may not necessarily belong to the government in the Islamic system unless the issues of justice, improving the economic welfare of the poor, and market failure are much crucial in determining whether or not this kind of



service should be provided by private sector or by the government unless they are financed by revenues from public property; in the latter case those functions and others should be taken up by the government as part of its strive to service the best interests of people.

## **C) MAIN FEATURES OF FISCAL POLICY IN ISLAM**

### **1. Objectives of Financial Policy:**

It seems that the Islamic economic system agrees generally with other systems on the economic objectives of fiscal policy, especially that these objectives are usually broad enough to suit different economic systems and ideological view point. Consequently, the objectives of distributive justice, price stability, growth and development, and full employment are fairly considered for the fiscal policy in Islam as well as in other systems.

### **2. Tools of Fiscal Policy:**

The basic difference comes in the tools of fiscal policy. Since the Islamic system provides clear protection to individual freedom and private ownership by regulating them in *shari'ah* itself and not allowing the collective decision making in the society to infringe on the private individual's rights.

The basic tools of fiscal policy may be represented in the following:

#### **i) The use of *zakah* as a tool of fiscal policy**

It is known that *zakah's* basic features are determined in *Shari'ah* in a Divinely manner which means that humankind has no right to make any change in these basic features. Consequently, fiscal policy can not change the rate of *zakah* imposed in *Shari'ah* on different kinds of assets and incomes, it cannot alter the exemptions stipulated, nor the imposition of *nisab*, or the categories of *zakah* recipients.

However, even then within these limitations there is still a reasonable room for fiscal policy to utilize *zakah* as a tool to promote the economic objectives of the state without violating any of the stipulations of *Shari'ah*. Thus, the choice of date of collection and distribution of *zakah* is one of the tools that could be used. In other words, *zakah* can

be collected in advance or delayed for one year or more by government. Also the collection and distribution of *zakah* can be made either in cash or in kind and the cash-kind combination of collection and distribution is also another tool of fiscal policy. Additionally, the government may choose to distribute some portion of proceeds of *zakah* in terms of equities of productive assets - either already existing in the market, or newly constructed by *zakah* proceeds themselves.

**ii) Revenues from Public Property can also be used as a tool of Fiscal Policy:**

Thus determining the *kharaj* of the land and methods of its collection provide an important tool of fiscal policy. The utilization of *kharaj*, i. e. the combination of public sector investments and consumption, and choice of projects is another important tool. Also pricing goods and services produced by public sector is another tool. A third tool in the hands of policy-makers relate to the investment of the surplus of the public properties' revenues.

- iii) Taxation is also another tool in the hands of fiscal policy (whenever it is permitted in *shari'ah*).
- iv) Resorting to *Mudharabah* and *Musharakah* financing of the project of the government income-producing projects can also be another tool of fiscal policy.
- v) Also public borrowing provides another important tool of fiscal policy in the Islamic economic system.

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## DISCUSSION

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### Chairman

Now we open the floor for questions and answers.

### Question

Br. Monzer Kahf, I have personally benefited by your lecture, especially from the discussion of *Kharaj*. I was in-charge of collection of Kharaj when I was in the Ministry of Land Revenues. The principle of Kharaj is one of the schemes in the Islamic economy that was not known here. There was a committee on the system of land revenue, there I recommended that this land revenue may be collected in accordance with the principles of Islam and then I had to explain it. I have, very much, benefited in the same that, in future, when I shall make it a recommendation to the government to introduce reforms in land administration and collection of land revenue, I shall mention it in my report.

I would like to know, from Br. Monzer Kahf, the relationship between this *kharaj* and *ushr*. There is the *kharaj* to be collected from some sort or class of land and *ushr* from others. I would request Dr. Monzer Kahf to tell something on this so that I can put it up to my government in future.

### Monzer Kahf

This is useful question and I appreciate its asking. The *ushr* applies only to the land owned by muslims and *ushr* is a form of *zakah*. The *zakah* on land produce is called *ushr*. The rate of *ushr* is 10% of the produce, if the land is fed by river or by rain. If water used in farming is extracted from underground by spending a large amount of effort and cost, the rate becomes 5%. This *ushr* is thus a kind of *zakah*. When we talk about *zakah*, we usually mean *zakah* and *ushr* because *ushr* is the name of *zakah* on agriculture.

On the other hand, *kharaj* is a rent of the land owned by the state, or -by *the ummah* as represented by the state. Now, in modern application, the land of countries like Egypt, Jordan, Syria, Palestine, Persia and Iraq are all *kharaji* land since they were conquered by Muslim forces in the first century of *hijrah*.

There were areas where muslims mainly converted to Islam, Bangladesh as one of them; people in this land became muslims on their own by accepting this religion. Those lands are owned by Muslim individuals not by the *ummah*. They are *ushr* lands, not *kharaji* lands, like the land in Madinah, where you take only the *ushr* from its produce, i.e., 10% or 5% depending on the source of water.

A question arises whether it is permissible to impose a tax on this land. I should say, when we talk about taxes, the principle is to apply justice implying that taxes should be taken from the rich, not from the poor. If we impose a tax, on every piece of land, even those lands owned by poor, where the land can hardly produce what is sufficient for the sustenance of its owner, definitely this is an unjust tax, it cannot be justified in Islam. Suppose we need a tax; and it is established that there is a need for it; most likely in a country like Bangladesh where there are little natural resources owned by the *ummah*, one may easily establish that there is a need for taxes. O.K. We need to impose taxes. In a rich country like Qatar, perhaps there may not be any need for imposing taxes. Now, if you impose taxes, you can select any form of taxes, on land, on wealth, on income, on export, on import, any kind of taxes as long as you preserve the principles that Islam stipulates for taxation. For instance you may tax each lot of land owned by the rich regardless of ownership and output, but you may not tax the land of the poor. This is not a *kharaj* because *kharaj* is a rent of the land regardless of who is the occupant. There is a funny thing in the Western taxation system, which seems to be totally unacceptable from the Islamic point of view. Since most taxes in the Western system are on income, you can avoid taxes completely within the law, by using loopholes, such as re-investment of return, buying municipal bonds, etc. Is this acceptable from the Islamic point of view? No. It is not. Because richness is defined in terms of either wealth, or income or any combination of them. Let us look at *zakah*. A person, say, owned a million Dollar. He/she is *Zakahable*. This person may have a mishap that burns half his/her assets or may have a loss of half a million Dollar. Would we still take *zakah* from this person at the end of the year? Yes, we do. He/she is *Zakahable* for the remaining 500 hundred thousand Dollar, because he/she is still rich. So, inspite of the fact that he/she made a loss of 500 hundred thousand Dollar, we take *zakah*. Now, let us turn to taxes, do we take taxes from such a person in the Islamic system? Yes, we do, because he/she is still rich. In the American, and most European systems, this person pays no income taxes.

### **Question**

Would the presence of inflation justify charging interest?

### **Dr. Kahf**

There is no one to one correspondence between inflation rate and interest rate. It has not been established whether one causes the other or not because there are observations on the tow sides. Interest sometimes increases with a decrease in prices and sometimes with an increase and vice versa. Secondly interest is not paid to compensate for inflation simply because of the fact that some times you have a negative real interest rate. When you deduct inflation rate from nominal interest rate, you find it in the negative, yet still people put their funds in the Banks and get this negative real interest. It is an established point that interest is not paid as a compensation for inflation and that is a known fact so much indicated in analysis. Thirdly, from the Islamic point, one may ask whether the debtor is the one who causes inflation, or the government, or the banking system or some other agent, internal or external? If the debtor is not the cause of inflation, why should he/she pay for it. Those who benefit of inflation by printing more money or by any other way such as expanding banking credit should be charged to compensate those who are hurt by inflation.

### **Question**

In 1980 you lent some one 1000 Lira and now in 1990 he want return of that amount. In this case should the lender be compensated? not in terms of the money, but some thing equivalent, something of the same value at that time, say a piece of land planted with trees and now he wanted to be compensated with the price of that land today?

### **Dr. Kahf**

Brother, I am sorry. You made a right point but in a wrong concept. Let us refer to the first part of a resolution by a seminar or workshop of certain *Shari'ah* scholars and economists which we held and in which I was present in Jeddah in IDB premises. It says: any lending or commitment, in money terms, should be paid back in money terms, one unit for one unit only.

The second part of the resolution relates to the case where there is no value for that currency in today's life. The currency is totally annulled or lost the majority of its value, like what happened to the Lebanese Lira, i.e. we are not talking about 10 or 20, or 50% inflation. The first part of the same resolution literally says the following:

If the currency loses almost all its value like what happened to Lebanese lira. It used to be 1 1/2 Lebanese Lira for one US \$, now it is 8,000 Lebanese Lira for the \$. It went down to some 1/10,000 of its previous value. Its value has almost vanished. In such cases you go back to some physical arrangement for repayment. However, this resolution was taken to the *Fiqh* Academy and the *Fiqh* Academy did not want to give opinion on the 2nd portion of it.

The *Fiqh* Academy represents all the 45 OIC member countries, it took only the first point that Debt can only be paid in terms of the same currency they were contracted in. Nothing else is recognized. Now, recently I am also involved in resurrecting the issue again to discuss cases that are not included under the resolution of the *Fiqh* Academy and I wrote to the Secretary General of the Academy that there is a need for instance for indexation of wages. Can we accept indexation of wages. An other thing was raised in the seminar but no opinion was given about it. Can we, from the time of signing the contract, chose certain arbitrary currency, say the US \$, and make our contract in terms of \$ but the actual deal is made in Bangladeshi Taka, yet we pronounce the contract and write it in terms of \$. I give you the equivalent of 10,000 \$ in Taka when I give you the loan and a year from now, I get the loan back, I need to get the value of \$ 10,000, or by using a nominal accounting currency like the SDR or European currency units, or what we call Islamic Dinar, which is another name we like to use in the IDB for the SDR, i.e. a nominal imaginary currency or accounting unit. This issue was also postponed.

## Questions

Mr. Abdul Aziz from the Islamic Economic School: What is the concept of state in Islam. You described the definition as taking care of interests of people in their life etc., but what is the concept of state. I like to draw your attention that Islam defines state as a Complex Rule like Bangladesh, Pakistan, Sudan, Malaysia, but in my opinion the state concept will be an integrate Rule. How would you define a state?



### **Dr. Kahf**

The definition of Islamic state: it is a state where we have supremacy of the word of Allah and His religion. In the constitution of any country, the first clause usually mentions to -whom belongs the supremacy. In an Islamic constitution, the first important clause should state that the supremacy belongs to Allah *Ta'ala* and His *Shari'ah*. This means that the whole model of the state and all its functions, economic, social, political, are organized by *Shari'ah*. This definition is comprehensive, the constitution is based on the *Qur'an* and the supremacy belongs to the source of the constitution. What is happening in the Muslim world today is that this supremacy is not given to Allah *Ta'ala* and to His *Shari'ah*. You find a number of countries stating to be Islamic but they don't recognize the supremacy of Allah *Ta'ala* in terms of applying His Words, His *Shari'ah*, and His religion. I think the best definition of the Islamic state is: it is a state where Allah *Ta'ala* and His Will are supreme.

### **Question**

What will be the shape of a bank rate, whether it should be there or it should be modified or do an Islamic state require at all a bank rate or not?

### **Dr. Kahf**

When the State Bank of Pakistan provided for the change to Islamic Banking system, it restrained using the Bank rate because the bank rate is based on the interest concept. So what they did, they have instead of it, formulated several devices of control over the banks.

One of them is to determine a ceiling for *Mudharabah* and *Musharakahhh* return i.e. to say if the income of the Bank exceeds certain percentage of capital, then the Bank gives up what is above that percentage to the customer and they use it as one of their control devices in controlling financing through *Mudharabah* and *Musharakahhh*. For instance, if the return is more than 12% at one time, the Bank should give up what is above this 12%. The concept of *Mudharabah* and *Musharakahhh* between the Bank and customers goes in the way of distributing profit not rate of return on capital, i.e. the Bank say puts \$ 1,000, with a share of 30% of the profit. Now you produce a profit, if it comes to be above 12% of its principal, then the Bank was forced to give up what is above that. The Central Bank uses this rate as leverage on Commercial Banks in its monetary policy.

Another thing used is the rate of return per annum on *murabahah*. This rate is determined directly as in determining the interest rate, because it is close to interest rate. They will tell, O.K. you give *murabahah* at 10%, 10 1/2% or 9%. So they use this as a tool of economic policy.

They also use a third tool. When a commercial bank feels any difficulty and that it needs cash from the central bank, here they use another rate which is the rate of sharing income of the commercial bank with the central bank. They give banks cash support. Suppose the total amount of principal and deposits, a commercial bank is using in its business is \$ 10 million, and in one shot 1 million is to be supported from the central bank for 10 days. They calculate their business total amount for the whole year, certain amount, time No. of days out of 365 days and they calculate \$ 1 million for 10 days and share the profit according to the ratio of profit sharing imposed by the central bank. The central bank affects this ratio by raising or lowering it as a tool of policy. So they have used 3 tools of policy for affecting the behavior of the commercial banks. They don't use the bank rate or discounting.

### Question

Many points were cleared by Br. Monzer Kahf, but still some confusion remains. Why the *Fiqh* Academy is telling that the same amount of money and same currency should be returned in the loan? Why the *Fiqh* Academy is not implying that the money should be in real terms, real value, value of the money should remain the same? Whether it is implying or not, this is one point. Another point Br. Monzer Kahf, in the economy liquid cash money joins part of capital, when physical capital can get a return, then it seems not to be understood to our common knowledge that liquid part of capital should not have any compensation even not to be compensated for inflation erosion. I mean owner is not getting more but just he is getting what he used to have earlier. It may be understood that one should not keep any-cash money, one should put every thing in bricks, sharing money, profit and loss sharing money, or in any form. In that case I would like to draw your attention to another point that some money must be kept ready in the pocket, in the board for temptation purpose, and note that the minimum amount of money that you require to keep should be compensated for inflation. I mean, that you have to go back say after 2 month, 3 month or 4 month, for that small period how can you lend that money to the rich without a sharing measure? That this point of inflation is so important that, Brother, this fundamental question should be addressed again and again may be

in other places also, so that we can have some sort of clear idea from the Scholars about whether inflation should be compensated or not. Thank you.

**Dr. Kahf**

See, Brother, in the *Fiqh* Academy resolution it is very clear by saying, unit for unit, regardless of the real value. It is literally regardless of any change in its real value. This is what the resolution and its is very clear in that sense. It does not even talk about the cases where the total value of the money is eroded like what happened in Lebanon.

For the point of compensation for inflation, I think we have two things to settle. First, interest is not a compensation for inflation and you rightly said it, the real balances in my pocket do not earn interest. How come we say that interest is a compensation for inflation. Once we separate these two issues, we come to discussing the inflation separate from interest. In other words, the fact that there is inflation does not give justification for payment of interest. Now, inflation could be caused by several factors, internal or external and it damages definitely at least two kinds of people: those who have their assets in monetary terms or those who have their contractual income also in monetary terms. If there is any body to compensate for inflation or pay for it, why should that body be the debtor, specially there are cases where there is no debtor at all. Like your cash balances in your pocket, there is no debtor here. Take it exactly the same way, to the depositors in Banks, why should banks be responsible for compensating these depositors or any other lenders.

On the other hand, if you look from the point of view of using the money, and benefiting from it then fine. Let there be compensation with regard to the usage not with regard to inflation. Suppose there was no inflation at all, level of price does not change, would there be still compensation for the use or not? There would be and there is a moral and religious justification for that compensation for the use of money. But that compensation must be related to the actual use and nothing else. Now, if you use this money and made profit, you give part of it but if you use it and don't make any profit, what would you distributes? There is nothing to be given if you make losses. This loss is obviously carried by the owner of the money because it is his money that decreased. He had 1,000 and now he has 700, so the same should be applied. I don't deny it at all, that user of money should compensate the owner, but they compensate them on the basis of the output of the use and nothing else and that is what we call *Mudharabah* or *Musharakahhh*. If they contribute in the

decision making it is *Musharakahhh* and if they do not contribute in the decision making, it is *Mudharabah*. This should be put in clear terms: the use of money is another issue separate from inflation. The justification for compensation for the use is not related to inflation. It is related to use itself and the outcome of that use and that is there and will be variable not pre-fixed. This means the use of money does not justify interest!

Now come back to inflation. Whoever causes inflation should be responsible for it and not anybody else. If there is an outside cause as said by Brother Qahtani, who is going to follow that outsider? I think in that case probably the government should be responsible to compensate you for the real balance in your pocket that lost their value because of imported inflation, no body else can relieve you from this kind of inflation except the government.

There is one point which should be kept for the coming meeting of the scholars on economy and *Shari'ah* that we are trying to hold. Can the state, under certain circumstances or conditions that should be stipulated, make what we call "good manners" of payment, can the state make it obligatory on the debtor. I.e. if I am a debtor, I am advised by the Prophet (Pbuh) to make good gesture to cover the lender. If I make this in terms of a gift or an additional payment which is not contractual or not in exchange, I give it just voluntarily. In case of inflation i.e. erosion of value of money, can the state make this amount of good gesture obligatory so that the other party is not afraid of getting less than what he/ she gave. This is an issue that is on the agenda for discussion.

***CHAPTER NINETEEN***

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# ISLAMIC BANKING

Munawar Iqbal\*

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The topic on which I am going to share my views with you this morning is Islamic banking which is a very important area in the field of Islamic economics. With the grace of Allah, Subhanahu wa Ta'Ala, more than one hundred Islamic banks and financial companies are now working in the field of financing all over the world in Muslim as well as non-Muslim countries. The theoretical work on Islamic banking has already been completed. Naturally, when the model is put into practice, it faces a number of problems and difficulties. It is the job of theoreticians as well as practitioners to confront difficulties and problems and to suggest solutions. In this regard, a number of conferences, seminars and workshops have been held on the contemporary problems facing Islamic banks. Therefore, the literature on the subject is quite rich.

I will give you a broad outline of the theoretical literature as well as some idea about the kinds of problems which Islamic banks and financial companies face in practice.

The rationale of Islamic banking is very clear and we are all aware that Allah Subhanahu Wa Ta'ala has declared **Riba** to be *Haram* and **bad, the secular** or conventional model of banking, is based on interest. This is not suitable for implementation in Muslim countries as the dealings of Muslims cannot be conducted on the basis of interest.

Therefore, all Muslims have to deal individually, as well as collectively, in the field of banking and finance under some arrangement, under some contracts, which do not involve *Riba*.

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There have been a number of discussions in the literature about what constitutes *Riba*. Are interest-bearing commercial loans *Riba* based? Are loans which are given to the government *Riba*? The literature, as I said, is quite rich. I can tell you that a very large majority of Muslim scholars, both jurists as well as Islamic economists, are of the view that all kinds of interest are prohibited. There is no distinction between interest and usury as some people may think. There is no distinction made between the purposes for which a loan is taken. Whether for business needs or not, the law applies to all loans.

First, the basic difference which we have to keep in mind is that in a loan contract the principal amount is guaranteed. This is one important characteristic of a loan contract which may involve *Riba*. The principal amount is guaranteed to be returned. .

Secondly, in a *Riba*-based loan, the borrower undertakes as a condition of the contract to pay something extra to the lender. If these two conditions are fulfilled, irrespective of whether a loan is for commercial purposes or for production purposes it involves *Riba*, *Riba al Nasi'a*. (Of course, we are not dealing with other kinds of *Riba* here, such as, *Riba al Fadl* or *Riba al uyu'* which are involved in trading and which are not the subject of this lecture).

As far as textual references are concerned, even on the basis of reasoning, *Riba* , or interest, has to be prohibited in Islam because Islam is a religion which emphasizes justice to all parties and the *Riba* contract, i.e., the interest-based contract, involves injustice to one of the parties. This is important and many people do not realize that a *Riba* contract sometimes even unjust to the lender in addition to being unjust to the borrower.

In most underdeveloped countries, it is perhaps more unjust to the lender, and I will explain how later.

The *Riba* contract, or interest contract, is unjust to the borrower because if somebody takes a loan and uses it for his business, he may earn a profit or he may end up with a loss. Now, in the case of a loss, the person using that money, let us call him the entrepreneur, loses his labor as a result of the loss, and he has to pay interest and the capital to the lender; whereas the lender; or the financier, in spite of the fact that the business or the enterprise has ended up with a loss, gets his money as well as his interest. This is unjust. Islam wants the relationship between the parties to be based on justice.

Now, let me tell you how in most cases interest contracts in underdeveloped countries are unjust to the lender also. In most underdeveloped countries or even developed countries today, most borrowers are big capitals. These industrialists borrow from the banks and they pay perhaps a 10 to 15 percent rate of interest. We know that if the rate of inflation is higher than that, then the real rate of interest becomes negative. The lenders are small savers like you and me. Banks collect the savings of all small savers and give loans to the industrialists who on a rate of interest of 15 percent which in the real sense is not even equivalent to the rate of inflation. Based on that rate of interest and minus the administrative expenses of the bank and their own margin, they pass this on as the difference between the borrowing rate and the lending rate. The banks give a very small rate of return to the small savers, and we know that in an inflationary environment, the real rate of interest is often negative.

Therefore, had these savings been invested on the basis of profits sharing, they would have had a much better return, and, as I will explain later, profit sharing is automatically adjusted to the rate of inflation whereas the rate of interest is not. Therefore, both on the basis of '*Aql* (rationale) and '*Nql* (revelation) or textual reference *Riba* is rejected. As far as reasoning is concerned, interest or *Riba* is unreasonable and uneffectable in an Islamic law. Now let me say that on the basis of economic reasoning, Islamic banking, or modes of financing based on sharing, is superior purely on economic grounds to an interest-based arrangement.

One reason for this, as I have mentioned, is that equity is ensured between the borrower and the lender. We know that in most countries, even in a country like the United States which is in the forefront of the capitalist model, there are regulations which place upper limits on the rate of interest of an interest-based contract. One famous regulation in the United States (Regulation 'Q') places an upper limit on the rate of interest stating that banks cannot pay higher than this rate of interest. Now, we know that, in many countries the rate of inflation sometimes reaches 50 percent. In Latin American countries the rate of inflation is sometimes 1000 percent, and as for Muslim countries, in the early 1980s, the rate of inflation in Turkey was more than 50 percent. Never in the history the rate of interest of the banks has gone in this country anywhere near this rate. In many countries banks are legally prohibited from paying a rate of interest higher than the one specified by law. Therefore, a contract which is based on interest cannot adjust itself. The rate of return cannot automatically adjust to the rate of inflation and lenders are, therefore, at a disadvantage.



With profit sharing, since prices increase and the rate of return of the project also increases along with the rate of inflation, the real rate of return does not end in a loss. The real rate of return is positive. In a small number of cases, there may be a few enterprises which end in a loss, but by and large in a growing economy, the rate of return is positive, and enterprises will normally achieve, a positive real rate of return. Both the borrower and the lender will share in an equitable manner that rate of return.

Also from the point of view of equity, the distribution of credit in an Islamic banking system is more equitable than in an interest-based economy. The reason for this is that in the case of profit sharing, banks are interested in getting a larger return. Of course they are concerned about the safety of the capital itself, but in an interest-based system, the safety of the capital is the sole criterion, because the rate of interest is fixed, and the bank's main concern is that it gets its principal as well as its interest back, i.e., fixed interest. In a profit-sharing arrangement, banks will also try to maximize their profit as will the entrepreneur so that they have common interests. They are working for the same purpose, for getting a better return which they will share. Therefore, if a person has low credibility (a small entrepreneur on idle enterprises), but the potential of his project is high, banks may be willing to finance that project because they will get a better return for their investment. This is not the case in an interest-based system because the rate of interest is fixed.

Therefore, small savers and small entrepreneurs who belong to the lower and middle classes have an opportunity to get finance from the banks. In an interest-based system, most of the funds, (and this has been proven empirically), flow to large industries, multinational corporations and big industrialists. Small savers and middle class small entrepreneurs do not get financing even for very good projects. Therefore, the distribution of credit in an interest-based system is directed in favor of large, rich industrialists, whereas in a profit-sharing system, bank finances will be more equitably distributed.

Additionally, a profit sharing system is also more efficient. It is more efficient because banks are interested in productivity. Therefore, funds will go higher or more productive enterprises. As I have mentioned, in an interest-based system, the sole criterion for the distribution of credit is the credibility of the entrepreneur. Here the criterion for the distribution of credit is the productivity of the project and, therefore, the financing will go to the more productive project. In this way the allocation of resources instead of going to low-return projects belonging to people with credibility, will flow to high-return

projects even if the credibility of the enterprises is lower. Therefore, the system is more efficient in the allocation of resources.

It is also more efficient because the bank's return is now directly related to the project itself. Banks are more careful in project evaluation than they are in the interest-based system. In the interest-based system, they do not care much about project evaluation. In the case of profit sharing or Islamic banking, banks have an interest in the project itself, and they will evaluate the project very carefully. This will ensure that funds are allocated to more efficient projects and that the efficiency of the system will improve. Moreover, since Islamic banks have an interest in the project, they will also take part in the management of the project, since they are specialized in the area of finance and investment. They will develop the necessary expertise in project evaluation, project monitoring, and project supervision. That expertise will also improve the efficiency of the project and the allocation of resources.

The third criterion that we usually talk about in economics is stability. From the point of view of stability, the Islamic banking model is more stable than the conventional banking model. I am talking here about the stability of the banking system not of the economy. In an interest-based system, there is a lack of symmetry between the cash flow of banks and that of entrepreneurs, because entrepreneurs or businessmen have to return a fixed rate of interest that bears no relationship to the actual return on the project. Therefore, if the project is not going well at some stage, this results in an asymmetry between the cash flow and the cash outflow of the project which creates instability in the business sector itself.

On the other hand, in the case of the interest-based system banks lack equilibrium in their assets and liabilities because their assets are fixed and their liabilities vary. Therefore, when there is any external shock, there is no automatic mechanism which can restore equilibrium between the assets and liabilities of the bank. In the Islamic system, the liabilities of the bank are also variable, therefore, if there is any shock, it equally affects the assets as well the liabilities of the bank. An example of this is the money which banks have borrowed from small savers/depositors. In the Islamic banking system, these liabilities, as you are aware, are also on the basis of *Mudharabah*.

I should mention that the Islamic banking model is based on a two-tier *Mudharabah* system: one *Mudharabah* is between the depositors and the bank. They place their funds with the bank on the basis of the *Mudharabah* or profit

sharing. The second tier of *Mudharabah* is between the bank and the businessmen or entrepreneurs.

Therefore, the Islamic banking model is based on this two-tier *Mudharabah* or at least one prominent model of Islamic banking is based on this two-tier *Mudharabah*. Now, if in some situation there is a recession or the rate of return goes down, this will automatically affect the assets of the bank. The assets will decrease, but at the same time, in the Islamic banking model, the bank's liabilities to its depositors will decrease. It does not have to pay a fixed rate of return to its depositors. The bank's liability is related to the actual performance of the project and, therefore, its liabilities will also decrease. There is a mechanism which will restore the equilibrium between the assets and liabilities of the bank. Therefore, there is a very small likelihood of bank failure because even the principal is not guaranteed because the depositor gave it to the bank on the basis of *Mudharabah*.

The distinction between a *Mudharabah* contract and a loan contract, which I mentioned earlier, is that in a loan contract the principal is guaranteed, while in the *Mudharabah* contract the principal is not guaranteed. Therefore, in a recession the principal of the depositor with the bank is also not guaranteed. Both liabilities and assets are affected by the same forces, and there is equilibrium between the assets and the liabilities of the bank. Therefore, the banking sector is more stable in profit-sharing arrangement than in a conventional banking.

The fourth criterion upon which the economist usually judges is that of growth. From the point of view of growth, the Islamic banking system is also better than the conventional banking system for the following reasons.

First, the Islamic banking model encourages innovation. Innovation is not something on which large industrialists have a monopoly. Anyone can be enterprising; any one can have a good idea. As I mentioned earlier, the Islamic banking model is based on a better distribution of credit. Small or middle class entrepreneurs, if they have a good project, will have the opportunity of getting a loan and will not be held back by the fear of tremendous risks. We know that innovation goes hand in hand with risk. Since the risk will be shared by the financier and entrepreneur, the Islamic banking system also have a better distribution of risk. This risk is spread over a larger number of people. The entrepreneur is only risking his labor and the bank is risking capital. Therefore, industrialist form of entrepreneurs will be forthcoming. Since all his patent is

his labor, therefore, innovation is promoted in an Islamic banking system because of a better distribution of the sharing of risk.

Secondly, the cost of capital is one of the conditions for the determination of the rate of investment in the economy. The cost of capital in an interest-based system is fixed, which is the rate of interest. In an Islamic economy the cost of capital varies with productivity. Since the lender gets or, I should say the financier gets, a proportion of the profits of the project, there is no fixed cost of capital, i.e., the cost is variable. Therefore, in the periods when there is a recession and productivity goes down, the cost of capital also goes down. This does not have a deterrent effect on investment which the fixed cost of capital has. Therefore, relatively speaking, there will be greater investment in an Islamic economy or in a profit-sharing economy as compared to an interest-based economy.

The Islamic banking system is also critically fair. Everything that we have been talking about is a question of fairness. Therefore, I have shown that even in the most crude sense of the word, the Islamic banking system is more equitable, efficient and stable and that it is also better from the point of view of growth.

Having dealt with the theoretical characteristics of Islamic banking, we now come to practice. Let us accept as given that the Islamic banking system is, at least, as efficient as the conventional banking system in theory; but is it in practice? Does the model work? The answer is: Yes.

As I mentioned earlier, one of the models given by Islamic economists, the model of two-tier *Mudharabah*. Based on the existing literature *Mudharabah* is not the only mode of finance which Islamic banks can use. In practice, Islamic banks and financial companies have come out with a number of new financial institutions to cope with the modern day requirements of business and finance.

One of these is *Musharakah* which differs from *Mudharabah* in the sense that in the pure *Mudharabah* model, one party gives capital and the other party contributes labor, while, in the *Musharakah* model, both capital and labor are shared, i.e., the parties share in the capital as well as labor and in the management of the principal itself. So, sometimes we find that a pure *Mudharabah* model is not workable, because if there is no change in the management of the project, there is a possibility that the businessman may

cheat. I will come to this later on. The moral hazard problem is one of the most important and most vicious problems which the Islamic banking movement is facing at the moment. I will discuss possible solutions to this problem when I discuss the problems of the Islamic banking movement. In *Musharakah*, banks as well as businessmen can negotiate the profit-sharing ratio, that is, the profit can be shared in any ratio that the parties want. However, loss has to be shared strictly in proportion to the capital contribution of the partners, and this is not negotiable.

The most popular form of finance used by Islamic banks is *Mudharabah*, or the markup system, in which the bank and the businessmen agree in the following manner. The businessman may, for example, require certain commodities, machinery or raw materials. He approaches the bank to make the purchase for him. The bank purchases the item, whether from the local market or from abroad, with its own funds. The commodities are handled over to the businessman on a fixed profit margin called markup or *Mudharabah* increment. This form of business is permissible in Islam and as a matter of fact, it is a form of *Bay'al Amana*. The basic characteristic of this kind of banking practice, *Bay'al Murabahah* is that the seller declares his costs as well as his profit margin. The seller says, this is the cost of a particular product to me and I want to take so much profit. I want to sell it to you at this price. This is the arrangement in *Bay'al Murabahah*.

The Islamic bank has brought this kind of trading practice into its field of financial mediation and it buys products for its customers and then sells the products to them at a preagreed markup. More than 80 percent of the banking practices of Islamic banks are being done on the basis of *Murabahah* or markup.

Another technique which can be used by Islamic banks is leasing or *Ijarah*. In this form of financing, banks will purchase machinery for customers. The banks will be the owners of the machinery and they will rent it to the customer on a fixed-rent basis. There is a number of versions within this leasing mode, one of them is sometimes called hire-purchase, or what we call lease lending with ownership. In addition to rent, the customer will pay part of the price of the product and to that extent the ownership of the customer will gradually increase in the product, and his rent will gradually decrease. By the end of the period, he will become the owner of the product.

Another mode the Islamic banks is the service charge, which is a fixed amount which banks charge on the services that they provide. Many of the

services are on loans of the Islamic Development Bank, for example, given to Muslim countries on the basis of a service charge i.e., a proportion of the principal amount which they consider to be an administrative expenditure of the bank. This proportion is supposed to represent the actual cost of administering the loan. It is therefore, revised every year according to actual cost. It does not include cost of money. When they collect funds, they have to spend money and these are administrative costs of the bank. Some banks cover these administrative costs by imposing a service charge.

Yet another mode is goodly loan, *Qard Hasan*, that is, they forgive the administrative costs of the loans or activities on the basis of *Qard*. In some cases the government, as in Pakistan for example, where banking was Islamized on a whole economy basis. The state bank of Pakistan prescribed that every bank has to give so much on the basis of *Qard Hasan* or "good loan". So, *Qard Hasan* is another financing arrangement which banks can use.

Another arrangement is *Bay'al Salam*. *Bay'al Salam* is the mirror image of *Bay' Mu'ajjal* or *Murabahah*. Technically, there is a difference between *Bay' Mu'ajjal* and *Murabahah*. In *Bay' Mu'ajjal* the commodity is delivered at the present time and the price is paid in the future. In *Bay'al Salam* it is the reverse: the price is paid in advance and the commodity or product is delivered in the future. *Bay'al Salam* can also be used in some cases. For example, the bank can provide certain raw materials to farmers either in cash or in kind. Then, when the crops are harvested, they pay the price of that commodity. The same thing exists in industry with a slight variation. If, for example, someone needs money in business, a slight variation in the *Bay'al Salam* called *Istisna'* is used. In the field of manufacturing, for example, the financing of textile mills, banks will give financing today and they will purchase the cloth or products of the mill after one year when the mill or the textile factory goes into production. This will be done, of course, at an agreed price and an agreed quantity. There are conditions for *Salam* which we cannot go into in this lecture.

Another arrangement which is being used in some banks, especially in Pakistan, is the "buy back arrangement". In the buy back arrangement, if someone, for example, a businessman, needs a loan, the bank will purchase his factory, building, machinery or any other asset. The bank will purchase the asset from the factory at a certain price and at the same time, it will sell it back to the businessman at a higher price. The difference being the price which the businessman has paid in consequence of the second sale in the contract. So, the businessman gets the money by selling, theoretically speaking, his factory or his

machinery to the bank. He sells it for one million dollars and then purchases it back from the bank for one and one half million dollars. The one and one half million dollars will be paid to the bank in two or three years time, so no transaction takes place. The only transaction is on paper. This is called *Bay al Ina* in Islamic terminology and the Prophet (Pbuh) has prohibited this kind of arrangement. Therefore, this practice which has been going on in some Islamic banks in Pakistan is something which has to be corrected.

There are other practices over which a shadow of doubt has been cast by Islamic jurists. Each bank has a *Shari'ah* board, which advises the bank on its practices and gradually the banks are improving. Therefore, all the tools are available to Islamic banks for financial practice and for fulfilling the needs of the businessman.

Now, having said that viable tools of investment transaction exist, let us evaluate how the Islamic banking system is doing in practice. I think that the performance of Islamic banking has been very encouraging. The growth of the Islamic banking movement has been very satisfactory. Islamic banks started in the mid-1960s, but the real movement started in the mid-1970s. Today, there are more than 100 Islamic banks and financial institutions. Their internal growth performance is also very satisfactory and their deposits are growing.

Their investments are growing and that demonstrates that the model is working. Also at the institutional level, there are certain banks which have been established. The Islamic Development Bank, for example, is working as a development and financial institution. *Dar al Mal of Islami* is working as a holding company, and many of these banks are working in a foreign environment. There are banks in England, India, the Philippines and Denmark. They are working in all environments, and they are showing a potential for growth. The results in most cases are satisfactory.

The most important thing in evaluating Islamic banking is to recognize that the fact that they are even managing to survive is a great achievement, because they are working in an extremely hostile environment. They require a higher liquidity ratio than conventional banks. They cannot compete with them because of the nature of their operation, and in many countries there are hostile banking elements working against Islamic banks. They are not permitted to enter into trading and, as I mentioned earlier, the nature of the Islamic banking model is such that they cannot survive without entering the field of trading. This is because the profit-sharing arrangement is not a simple financial

institution; it is actual participation in business. As you know, in the conventional banking framework, banks are not allowed to actually own investment projects, but that should not be the case for Islamic banks. However, in many countries where Islamic banks are operating, that law also applies to them. Hence, the very mode of their operation is threatened.

Until now, Islamic banks do not have any institutional backup like banks in the conventional framework. There is a whole spectrum of institutional arrangements, investment trusts, mutual funds, and stock markets where conventional banks can place their funds. There is a whole spectrum of financial or what is called nonbank financial intermediaries and stock markets in which they can operate, and they are parts of the financial market where they export to each other. This kind of arrangement, of course, has to be developed for Islamic banking. This is one of the most important things that the Islamic banking movement has to come up with. However, at the moment all of this institutional backup is not there. Yet, Islamic banks are surviving which is a great achievement. They do not have any lender of the last resort as do conventional banks.

Conventional banks can go to the discount window and borrow money in case of a crisis or in case of a run on the bank. Since Islamic banks cannot borrow on the basis of interest, they cannot go to a lender of the last resort, and, therefore, they are on their own. This is another very great disadvantage for Islamic banks. Islamic banks also have difficulties in the placement of funds. Conventional banks can place their funds internationally because, unfortunately, the entire world is now working on the basis of interest. Therefore, conventional banks can even place funds overnight. A bank which has excess liquidity in Tokyo can place funds overnight with a bank in New York. The Islamic bank lacks that efficient system of the placement of funds locally and internationally which is available to the conventional bank. Of course, that is the way in which conventional banks manage with a smaller liquidity. They place any excess liquidity even for a single night and earn a return. That kind of arrangement is not available to Islamic banks, so they have a great disadvantage in the placement of both long- and short-term funds internationally. However, this is especially true in the case of the placement of short-term funds. Islamic banks do not have the opportunity of taking advantage of these kinds of arrangements, and they suffer from other problems which I think are very crucial.





Most important is the fact that Islamic banks do not have sufficient personnel for running a banking operation in the Islamic system. Since it is a new model and a new system, it will take time to get enough trained and qualified people who can run that system efficiently. Many Islamic banks face great difficulty since they lack qualified and committed individuals who can run banking operations in an Islamic framework. They have a number of instruments and in practice they are catering to all the business needs of their customers. They have growth in terms of their deposits, and the fact is that they are surviving in extremely hostile conditions. I was talking yesterday to one of my colleagues who is working in the Islamic Bank of Dhaka. He said that the bank declared 15 percent rate of return per share whereas other banks have not had any return. Most other banks are also giving at least a comparable return to the depositor. Therefore, in Pakistan, when both interest-based operations and sharing accounts are compared, the profit-sharing operations declared a higher rate of return than the interest-based accounts. That is also the case of the Faisal Islamic Bank of Sudan. Some Islamic banks initially could not declare a higher return because of the problems which I have mentioned. Most of them give a comparable return to their depositors which is another source of satisfaction.

As far as practice is concerned, the most serious problem faced by Islamic banks is that they have been forced to operate on the basis of fixed return modes of financing which include the service charge basis and above all *Murabahah* or markup. They have their difficulties, as I have said, in that they have to compete with conventional banks and in this phase of their development they have to generate confidence on the part of their customers. Therefore, they, so to say, plan to sell their ideas. They do not want to take risk. If the Islamic banking movement is to prosper in the long run, they have to gradually move into more variable return which is to say that *Mudharabah* and *Musharakah* have to form the backbone of the Islamic banking movement.

However, for the time being, because of the difficulties that I have mentioned, they are forced to use fixed return modes much more than variable return modes.

Some people have alleged that there is no difference between the rate of interest and markup. Some banks may be just playing tricks. However, I will give them the benefit of the doubt. From a purely text point of view, *Murabahah* is permissible, that is, banks are allowed to make a profit by selling at a higher price on a credit basis than on a cash basis. This is permissible in Islam and most business as you know is run on the basis of the same *Murabahah*.

principle, i.e., if the cash price is 100 taka, the credit price will be 110 take or 120 taka. This is permissible in Islam. Banks can make use of that permission and the only important thing that they have to observe is that they must own the commodity. For example, if they are importing machinery, they are importing it as their own. If something happens, they are responsible so they must shoulder that responsibility. Even if they are insured against it, the liability falls on them and then they insure against it, they are responsible as they import in their own name and then they resell to the customers.

However, the problem in the long run is that since the Islamic banking system is more efficient and equitable with a greater potential for good, most benefits will come when it is run on a pure profit-sharing basis, that is, a variable return basis, rather than a fixed-return basis. If that is not the case, then the benefits of the Islamic banking movement are very limited.

Even though we say that it is Islamic, some people prefer to make a distinction between the interest-free banking system and Islamic banking. They say that even though it does not involve any interest, it cannot be called true Islamic banking for two reasons. The first reason is that they say that true Islamic banking must be based on profit sharing and risk sharing. I place more importance on risk sharing because the advantages which I mentioned are basically derived from risk sharing. So far as the present practice of Islamic banks is concerned, it is permissible from the *Shari'ah* point of view, as there is no interest involved in their practices. But that group of people say it is not Islamic in the sense of the benefits of Islamic banking which will not be forthcoming because the banks are not taking any risk, all of their modes are fixed-return modes, which do not involve any risk for the bank. Most of the risk still falls on the businessman.

The second reason is that they say that present Islamic banking practices may be interest free but not Islamic in the sense that Islamic banking is more than just the elimination of interest.

There is also the question of social objectives, helping the poor, etc. The social objectives of the Islamic system should also figure in the practices of Islamic banks, but I think that there should also be a benefit to the bank. I do not deny that Islamic banks should theoretically have a social dimension, but Islamic banks alone should not shoulder the responsibility for the social objectives of Islam in the Islamic system. There are a number of institutions which can share this responsibility. There are the institutions of *Zakah*, *Nafaqat*

*Wajiba, Nafaqat al Nafi, Akila, and Amr bi al ma'ruf wa nahi 'an al munkar.* There is also the institution of caring for your neighbor, the institution of state, and the institutions of Hisba, Mazalim, etc. A whole range of institutions is needed to fulfill these social needs. Society has to come up with these institutions as none of them exist at present. Islamic banks are working against tremendous competition from other institutions and if they give undue importance to social objectives they will be unable to compete and their failure will be counter productive. Therefore, even though I will not deny that Islamic banks should have a social dimension, I would think that realistically speaking, we should not place an undue burden on the shoulders of Islamic banks. At this point in time, we must also try to understand their difficulties by generating other institutions which will help fulfill social objectives along with Islamic banks.

I think that there are a number of other small points which I wanted to make, but I do not want to take up more time, and some of them may come up in the discussion. I will be happy to respond to any questions from the floor. Thank you.

**The Chairman:**

Thank you brother for presenting a very organized and articulated lecture on a most important topic. Brothers and sisters, we are going to start our discussion session. Please raise your hand if you have a question. Alternatively, you can send me the question with your name on it. Be sure to mention your name and limit the number of questions to two each.

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## DISCUSSION

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*Munawar Iqbal*

### Question

At the beginning of your lecture, you said that all types of interest are *Riba*, but at the same time you qualified this by saying that the majority of Islamic jurists and Islamic economists hold this view. Why only a majority? Why not all of them? Do you agree that there is a differences of opinion between Islamic jurists? Secondly, when you spoke of the special merits of Islamic banking over traditional banking, you mentioned a number of criteria, such as, justice, efficiency, equity and stability. But you did not mention the suitability and the justification of the criteria. Can you comment on this?

Thirdly, regarding modes of financing in Islamic banking, you have mentioned several: *Ba'y -Salam*, *Ba'y-Muajjal*, *Musharakah Mudaraba*, etc. Actually the Bangladesh Islamic Bank is interested to know why the distribution of finance is not through the alternative modes of financing? You mentioned that the alternate objective is to give finance through the modes of *Mudaraba* and *Musharakah*. Do you have any data on Bangladesh and Pakistan? What proportion of finance is done through these two modes as opposed to *Bay Salam* and *Ba'y-Muajjal*? In Bangladesh a very small proportion of total finance is concerned with the *Mudaraba* and *Musharakah* modes; financing mainly depends upon *Ba'y-Salaman Ba y-Muajjal*.

As to the comment on service charges I have been in Islamabad for sometime and I have long service. One of the bankers returned from Islamic bank of Pakistan, he said that I specialize in banking that's why I am interested to see how finance in Pakistan is done. I was told by ADBP that they are financing on the basis of service charge, as you have already mentioned. Service charge is to my mind equal to *Riba*. I find no distinction whatsoever between service charges and the interest. Whatever the system to give more details about, of course, he said that this should not be ultimately wanted to switch over to. During the establishment period we are doing this and I would like to know whether you have been able to switch over to some other alternative for the bank

service charge. You have in so many words, said that Islamic banks are still surviving definitely creditable but its survival. But this survival is due to the fact that there are some persons who are so devoted to Islam that they will support a bank whether it is profitable or not. Is it because of the contribution of these persons that Islamic banks are surviving? Or is there some other reason?

Finally, I would like to know whether the basic objective behind Islamic banking is to establish reallocation of funding and justice and I am interested to know whether you have seen the next page and are able to do anything about the establishment of an Islamic bank in Pakistan. Thank you, very much.

**Dr. Munawar Iqbal**

Thank you very much Dr. Munawar. You have raised a number of questions and I am not sure if time permits me to attend to all of them adequately. I will try to comment on each one of them very briefly as far as the problem is being faced in the case of the Pakistan experience. The most important problem (and I am glad that you brought it up) is the question of moral hazard. I would like to say that it is not only a problem in Pakistan.

Most Islamic banks when asked why they are not using *Mudaraba* and *Musharakah* in their financing and why they are relying more on *Murabaha* and other fixed return modes, answer that it is a question of the problem moral hazard. That is to say that businessmen do not declare the actual results of their enterprise. They maintain more than one set of books and declare smaller profits to the bank. Therefore, these banks are at a disadvantage.

I think that in the case of moral hazard if the system is allowed to work and Islamic banks have the courage to work purely on economic grounds then the moral hazard problem will disappear. Businessmen are more interested in a continued relationship with a bank. They have to get financing every year. So if they cheat once, they know that they will not get financing again. We know that in the business world Jews and Hindus dominate and do well because they know that if they cheat once they will not get the business again. If the same thing applies to the banking movement and if it is allowed to work for a few years, the cheaters will be eliminated from the market.

Regarding the distribution of finance through *Mudaraba*, *Musharakah* and other financing modes, I mentioned in my lecture that a very large proportion of bank finance is currently distributed on the basis of *Murabaha*. On an average this might represent 80 percent of financing, although exact figures

are not available, and they vary from one bank to the other. For example, the Dubai Islamic Bank and the Kuwait Finance House have a larger proportion in variable return modes than other banks. Similarly, the Faisal Islamic Bank in Sudan is doing more in terms of *Mudaraba* and *Musharakah* compared to some other banks. So on an average I would say that 80 to 85 percent of the funds are engaged in *Murabaha* and the rest in variable return modes, leasing, *Mudaraba*, *Masharaka*, etc.

Regarding whether service charges are different from rates of interest, if you ask me honestly, I do tend to agree with you I have a lot of questions to ask about the practices of Islamic banking in Pakistan and we do express that in various forums in Pakistan. We write to the government, and we have workshops and seminars. However, I must point out, as I mentioned earlier, that we are making a beginning. We have our own difficulties and we do not want to take too much risk at this point in order to lose the confidence of businessmen and their customers. It is because of these reservations that there was a system called markup in Pakistan which because of the objections raised by Islamic economists and jurists was discontinued. We hope that, Inshaallah, in due course of time these will also improve. This is why we have started calling it "noninterest banking" rather than Islamic banking. Therefore, I would say that we have reached the stage of noninterest banking and the stage of Islamic banking lies ahead of us Inshallah.

**Question: Abdul Awal**

First of all I would like to extend my thanks to brother Munawar Iqbal for the present discussion. The Islamic legal framework is very important to smooth functioning in our country, but the Bangladesh Bank has made some concessions to the Islamic Bank in the case of the liquidity ratio. All other commercial banks maintain a liquidity ratio of 23 percent, but for the Islamic Bank and Al Baraka Bank, the liquidity ratio is 10 percent. So this is a concession.

Also regarding the total banking environment, I think that there are many problems that prevent an Islamic bank from operating smoothly. In the case of the call money market, capital market, bond, stock and share market and short-term funds, Islamic banks cannot make interbank arrangements because of the interest base. Is there any mechanism that can help Islamic banks to deal with other banks in money market and interbank transactions? How can we

solve this problem? Secondly, should the discount rate for the purpose of project evaluation be calculated in practice?

**Dr. Munawar Iqbal**

As far as the first question is concerned that in Bangladesh the liquidity ratio for Islamic banks is 10 percent instead of 23 percent, it is a very welcome legislation. In Western countries where Islamic banks are operating, such concessions are not given. Bangladesh being an Islamic country gives this concession, but actually it is not really a concession. In the conventional banking system, the liquidity ratio is required because the funds of the bank are at the beck and call of the depositor. They can go to the bank and demand the money in their current accounts any time and in their savings accounts by giving notice. In most cases in conventional banks there are also savings checking accounts. So most of the funds in the conventional bank are at the beck and call of depositors. Therefore, they have to have enough liquidity to maintain confidence.

In the Islamic banking model since it is based on *Mudaraba* most of the funds should be on the basis of long-term commitment. Therefore, the requirement of the model itself is that the liquidity ratio should be smaller, so that should be the case in all Islamic banks, not only the ones in Bangladesh. As far as the interbank relationship is concerned, there is the possibility that they can get funds from other banks on the basis of profit sharing, and that they can calculate the share of profits on the basis of the daily product. There is a scheme which the Islamic banks are issuing. If you are interested in more detail, I refer you to the reports of the Council of Islamic Ideology. The Pakistan Council of Islamic Ideology published a book edited by myself and Dr. Ziauddin Ahmed, entitled, "Money and Banking in Islam".

Regarding your third question on valuation, because of the shortage of time, I think you should wait for the session on project valuation itself in order to get your answer.

**Question**

Could you please elaborate on the difference between the buy-back operation and the interest-based system?



**Dr. Munawar Iqbal**

I explained that buy-back is being practiced in Pakistan, but this is an operation which is not permissible as far as the Islamic jurists are concerned. Let us take the example of an individual. You need financing from the bank. You go to the bank and ask for financing. They ask if you have any assets? You say, yes, you have a house. You then agree to sell that house to the bank for, let us say fifty thousand rupees. So you sign a sell agreement with the bank whereby you sell the house for fifty thousand rupees to the bank. You get fifty thousand rupees. However, simultaneously, the bank sells the house back to you. You sign another sell the agreement with the bank which has become the owner of the house according to the first contract. The bank sells the house back to you for sixty thousand rupees which you must pay after one year. So your house remains with you. You have now bought it back from the bank. It is only a paper transaction. You received fifty thousand rupees by selling your house and you are obliged to pay sixty thousand rupees for buying your own house back from the bank after one year. This is only a paper transaction. There is no difference between this and interest. In fact you have fifty thousand rupees from the bank and you will have to pay sixty thousand rupees after one year. This is very similar to interest. In Islamic literature, this is called *Bay'al 'Ina*, and it is prohibited by prophet Muhammad (Pbuh).

**Question**

Brother I have received a question from Muhammad Muslihuddin from the Islamic Bank Bangladesh. The question is: You have mentioned in your lecture the profit-sharing mode. Should it not be the profit- and loss-sharing mode? Could you please clarify this?

**Dr. Munawar Iqbal**

He is asking whether we should call it profit sharing or profit and loss sharing. I personally prefer the term "profit sharing" but I have no objection if someone calls it profit and loss sharing. However, profit sharing is perhaps description of the system because of *Mudaraba* which is the basis of the two-tier *Mudaraba* is the basis of Islamic banking. In *Mudaraba* loss is not shared. The entire loss is sustained by the one who supplies the capital, the entrepreneur only loses his labor. In the case of profit, it is negotiable. They can share profit at whatever ratio they want. For example, in the case of *Musharakah*, if two people contribute equal amounts of money, they can agree that one person will

get a greater share of the profit and the other will, for example, get 60 percent of the profit. It is up to them to agree on whatever ratio (50/50 or 30/70) they want, but in the case of loss, they must share the loss strictly in proportion to their capital contribution, that is on a 50/50 basis. That is why the term "profit sharing" is a better description of the transaction.

### **Question**

Prof. Azharuddin. Thank you brother Munawar Iqbal for the presentation an interesting paper. You have mentioned that, in most cases, there is no project evaluation in the conventional banking system. However, in the Islamic banking system, projects are evaluated properly and action can be taken accordingly. o However, in our country in some cases especially in the Industrial Bank, when they give capital to the entrepreneur for a project, they also evaluate the projects. therefore, I cannot agree that conventional banks do not evaluate projects.

Secondly, you mentioned that there is a lack of equilibrium between liabilities and assets in the conventional banking system, but there is equilibrium in the Islamic banking system, i.e. there is no lack of equilibrium in Islamic banking. Would you kindly explain this further? This is not clear to me.

Finally, you have mentioned that the Islamic banking system is a two *Mudaraba* system. What are those two tiers?

### **Dr. M. Iqbal**

First of all, regarding project evaluation in conventional banks, I think I may have been misunderstood. I did not say that conventional banks do not do any project evaluation. If you understood me to say that, then I am sorry. They do conduct project evaluations but there is a difference. Their concern is to see whether the project will be able to generate enough cash flow to pay their interest and their capital installment. That is their concern. In the case of project evaluation in Islamic banks, their concern is whether the project generates a greater more return. Therefore, if you have two projects 'A' and 'B' and both are able to pay interest on the capital installment, the conventional bank is satisfied with both of them, whereas in case of the Islamic bank, it will evaluate the project from the point of view of profitability because it will share in that profit.

Therefore, funds will first flow to project 'A', then to 'B', and so on. So this is a more efficient allocation of resources.

Two-tier *Mudaraba*, one-tier is between the depositor and the bank. We place the money with the bank on the basis of *Mudaraba* so that we will not get a fixed rate of return. We will get a rate of return based on the profit which the banks receive in their overall operations. We will get a proportion of that.

. The second tier is between the bank and the businessman. The bank advances loans not on the basis of interest, but on the basis of profit sharing rather than liability and assets. Assets and liabilities are in equilibrium. In the conventional banking system, if there is a recession the rate of return goes down, but the liability capital, which is interest, is fixed. Therefore, there is disequilibrium. Because of the economic condition, the rate of return goes down, but the cost of capital is fixed so that there is disequilibrium between the cost of capital and the rate of return.

In the Islamic banking system, the cost of capital is also variable. The cost of capital is not deducted before, but rather after the deposit has finished and whatever there is whether there remains is either profit or loss. If there is a profit, a certain proportion will be given to the financier that is the cost of the capital. If there is a loss, nothing will have to be given to the financier. Therefore, there will be no disequilibrium between the returns and the liabilities.

#### **Question**

Excuse me. If there is any loss, then would not the loss of capital be on the part of the entrepreneur?

#### **M. Iqbal**

Not on the part of the entrepreneur. He will lose his labor. The financier will shoulder the loss. The entire loss falls on the financier, who has supplied the capital.

#### **Question: Professor Sulaiman Mondal**

Thank you, very much. I thank Dr. Iqbal for delivering this lecture. I actually attended this Seminar just to learn about Islamic banking. I happen to

have been associated with an interest-based bank, and I have come here just to share my experience.

I do not like to make any comments on what you have said about the merits of Islamic banking because there are counter arguments that also have merits. It is useless to go into the counter arguments.

I have a few suggestions. You say that Islamic banks here are based on a profit and loss sharing system, but I suspect that you should not call it this. How and why should our Islamic banks make losses? They are supposed to make profits and profits are to be made in order to create confidence in the members of the public. If they make losses and inflict losses on the members of the public, then people will lose confidence in banks. They will not have any confidence. The question is how to make a profit and how to avoid loss and that is my frank consideration.

It seems to me from the experience of the past four years, that is the case of interest-based banking, there is one problem. I should mention that since the money comes either from the government or an international financial institution, there is a national tendency within the banks management to allocate funds to projects that are willing to share percentage with the bank, or the bank would like to allocate funds to those projects which they think are profitable. The project evaluation done by the entrepreneur is not usually acceptable. Only the evaluation of the bank is acceptable to them. That creates a lot of problems. We have a huge amount of unrecovered loans a fantastic amount of unrecovered loans and most banks are in difficulty.

My question is: Can you avoid losses?

I think the management of the bank must check on the activities of the entrepreneur. A check on the evading on concealing of profits will be required. Banks will have to recruit very good people who can be trained in such a manner that they can evaluate projects. They can make the right selection of projects and will be able to make useful investments with good returns to the bank. That will require, I think, a recruitment policy of the bank which should be very crucial. They should recruit very good people, people who are directly concerned with business management, bank operations, etc.

At present, as you mentioned, most Islamic banks have recourse to a fixed return mode of financing modified in that the contract with the clients can

be done in such a manner that those who repay the fund on time as per the contract can be given some concession. For example, if the agreement is that the borrower will agree to pay a 15 percent return either on hire purchase or on fixed modes of financing and if the payment is regular and up to the satisfaction of the bank, then the bank can possibly make some concession to the borrower. On the other hand, the bank can possibly arrange to lend money to the borrower with a contract that should have a range of return on the amount borrowed which may vary from 15 to 7 percent. If the payment is good, then the bank can make a concession of 1 percent. If the payment is not good, then the bank can add a 1 percent additional charge. In that case it will be variable and it will create an incentive to payment and a disincentive to nonpayment.

**Dr. M. Iqbal**

There are a number of issues which brother Sulaiman Mondal has raised. Some of them are in the nature of a suggestion. He mentioned that Islamic banks are not supposed to make losses. I will only modify this by saying that Islamic banks should not make losses, but if they do then they have to bear the loss. However, by and large, I agree with him that we should support Islamic banking by all possible means in order to generate confidence in them. If they declare a good return, then they will get more deposits and more confidence from their customers. Islamic banks at present have variable returns many involving some risk

However, I would like to mention that if they take on risk, in due course their return will increase, because the higher the risk, the higher the return. This is a theory of finance that says that the higher risk also brings a higher return. The return from Islamic banks will be higher because they will be getting the return which is the true cost of capital at its premium and they will declare a higher profit margin to their depositors.

The second question regarded giving some concession to people who pay at the right time and penalizing those who delay. This is an important issue which Islamic banks are facing today. In the case of Pakistan, this system is being applied by banks when they sell a product. If the true value of the product is one thousand they will select for the resale contract one thousand and eight hundred and the tacit understanding between the bank and the customer is that if he pays only one thousand five hundred the amount will be marked down. This is one of the tricks which commercial Islamic banks are playing. It is the same as calculating on the basis of the rate of interest. The other side of it is an even

more important controversy in Islamic bank literature to which I would like to draw your attention. In case of default, since they are using markup or *Murabaha*, the Islamic permission is for the use of *Murabaha* only at the time of the contract. You can sell at a higher price on the profit basis than at the cash price, but at the due date if the person does not pay you, you cannot increase the price because the sale contract has now finished. Now that money is a debt or loan which the customer has to pay, and you cannot increase the amount of debt because that will amount to an interest or *Riba*. Then how can you deal with defaulters who do not pay on time. One Islamic jurist, Mustafa Zarqa, say that some penalty can be imposed on the defaulters, but the majority of Islamic jurists do not allow this. They allow placing a penalty on defaulters but that penalty should not be given to the government, not to the bank, because bank is not permitted to collect on the amount that has been due. They say that the purpose is to discourage defaulters. This problem can be solved. You place a penalty, whatever you want to impose, in a separate account which may benefit all Islamic banks or institutions in general. However, if you pay to the lender, then it will be interest.

### **Question**

As explained by the learned speaker, Islamic banks have a two-tier twital relationships, between depositors and the business enterprises. If the risks are equally borne and if the profit sharing is the process of passing funds through the banking to business, how to ascertain profit distribution on a crude technical law by the borrower? This is a question of moral hazard i.e., how to evaluate what is the exact rate of return or rate of profit? Do we believe whatever the businessman declares or are we allowed to ascertain for ourselves?

### **Dr. M. Iqbal**

Of course, as I mentioned, one of the most important problems which banks are facing is that of moral hazard. Islamic jurists allow that even under *Mudaraba*, the financier has the authority to check the accounts. If he finds any cheating the borrower can be penalized. Also he has to give the entire correct proportion of the profit. He can be placed on a blacklist and penalties can be imposed against him. Mr. Baital Mobaric, the Managing Director of the Faizal Islamic Bank of Sudan reported that when they were not monitoring the performance of the bank, the rate of return declared by the businessman was 5 percent. However, when they monitored the project and assessment of actual performance, the actual rate turned out to be 15 percent, and the additional cost

of monitoring was only 1.5 percent. Therefore, the bank was better off monitoring rather than leaving it to the businessman. In the case of *Mudaraba*, the banks can be responsible for getting their accounts audited by preagreed chartered accountants. In other techniques of monitoring any variation can be detected by Islamic banks.

**Question: Mohammad A. Khandoker**

Please explain the mechanism for striking a balance between conflicting principles of security, liquidity and profitability and how to replace the interest rate ratio with the profit- sharing ratio.

**Dr. M. Iqbal**

This conflict between security, liquidity and profitability affects the income of conventional banks as well as Islamic banks. Banks deal with this by having a profit on their advances more than the share they pay to depositors, in such a way that at a particular point of time they have enough liquidity. They do not overinvest and at the same time, they do not underinvest. In order to ensure security, they try to diversify their portfolio. One of the most important techniques for achieving security is to diversify their portfolio. The Banks are able to do pretty well because the larger the fund available at their disposal, the better diversification can be achieved. Instead of putting all their eggs in one basket, they put their eggs in one thousand baskets and in this way even if one project is not producing the desired result the bank is affected only a little. They come up by diversification, and they also manage the risk.

**Mr. Habibur Rahaman**

Thank you Mr. Chairman and thank you Dr. Munawar Iqbal for your presentation. I have just one query. Do you think that Islamic banks should visit industries or firms periodically to check whether the institution is run in accordance with Islamic principles (e.g., garments industries, fabrics industries etc.)? There is a saying in Bangladesh that Islamic banks should not poke their noses into the business of the firm, but should let it run according to its own way.

**Dr. M. Iqbal**

Thank you. The answer is, yes, I agree with you. At least at this stage of Islamic banking because of the moral fabric of society, Islamic banks should have some monitoring devices. They can visit factories, but these visits should be helpful to the industrialist, rather than merely be poking their nose into his business. One of the important principles of *Mudaraba*, the pure model of *Mudaraba*, is that the entrepreneur should be given a free hand in managing the funds so that he can utilize his enterprising capability in managing in order to generate more profit. The basic principle is that he be given a free hand because the basic assumption is that this person has the capability of managing funds better than the capitalist himself. If the capitalist is more qualified in managing funds he need not give the funds in the first place. That is the basic assumption. Therefore, if there is any need for going to the factories and mills, the Islamic bank should be helpful and should share its information and its expertise for the common interest, both of the bank and of the businessman in creating more profit. The businessman will not resent such a visit and such cooperation is essential for the bank. So the important point is to create confidence and understanding between the bank and the businessman.

**Question: Dr. Siraj**

I am interested in the distinction made by Dr. Munawar Iqbal between interest-free banks and Islamic banks. Do we have to impose on the Islamic bank at this stage certain social functions? Does it not go against the concept of commercial banks? These questions are very important and need to be tackled now, at this stage, to help Islamic banks develop. The accusation now against Islamic banks is that they are dealing with firms in the same manner as conventional banks. Indeed it is not enough just to say that you are not dealing in *Riba* and then to deal with money in the same manner as it is dealt with by others. So this needs more clarification and I would like to know if there is any literature on this point. Thank you, very much.

**Dr. Munawar Iqbal**

I am sympathetic to Islamic banks since they are facing a lot of competition and they are only just beginning. We should not place on them the undue burden of the achievement of social objectives. Let them try to get more return and create more confidence. In due course when they are well established and are able to compete with others, then they will also be able to contribute to



social objectives. However, I mentioned, there are many other institutions which have to share the responsibility of fulfilling the social objectives of an Islamic system. However, I do object to raising these issues because we have to keep an eye on the operation of Islamic banks. The purpose is not simply to change the name from interest to markup. Another thing we have to see is whether there is any undesirable feature involved and to what extent we can advise as we have been doing. More or less all Islamic banks, as I have mentioned, have a *Shari'ah* board.

Moreover, when a problem comes to their attention, they do take care of it, and try to adjust. If there is an undesirable feature in their conduct, they try to improve it. This is the way that the Islamic banking movement will, Inshallah, gradually move to the achievement of other objectives. At the present time, I agree with Dr. Siraj, as I mentioned in my lecture, that we should give Islamic banks a free hand in earning more profit in an Islamic way.

### **Question: Tajul Islam**

Many thanks, Mr. Chairman for allowing me to speak and many thanks to the lecturer. I would like to raise some questions in regards to practical operations. Islamic banks have many merits, but Dr. Iqbal did not mention some important demerits of Islamic banking that we are facing nowadays.

Firstly, brother Sarker raised the point that the legal framework for Islamic banking is worked out in many countries of the world, but it is very much a problem for our country.

Secondly books of operational instructions have not been published by any bank or any association. Islamic banks work with many modes. *Murabaha Bay'-Muajjal*, *Bay'-Salam*, *Ijarah*, etc.), and I think that there should be books of instructions for all Islamic banks working around the world.

Thirdly, there is a question as to whether banks or not should follow the principles of accrued profit. This is a question of how we resolve whether the banks should follow the accrued system of profit calculation or the realized system.

Fourthly, there is a lack of an appropriate atmosphere for '*Musharakahh*'. For instance, we started financing projects under *Musharakahh* at the time of opening. The bank financed 31 projects, but we could not

maintain them, and we transferred the liability to hire-purchase and other accounts because of a dishonest practice in the accounting system. I think all Islamic banks are suffering from these sorts of problems.

Fifthly, the issue of international banking has not been raised by anybody. Islamic banks are now operating comprehensively. We are working for import and export. There is no international Islamic bank to handle this trade because in London, and in Japanese and German trade centers, there are no important Islamic banks. Therefore, we are working with interest-based banks like the American Express, BCCI Bank, commerce banks of Germany and other banks. So I think that brother Iqbal is working with international Islamic banks to arrange operational Islamic banks properly in Islamic matters. Thank you all.

### **Dr. Munawar Iqbal**

These are not demerits of the Islamic banking system. They are administrative problems of Islamic banks, and they have to find ways to tackle these problems within a legal framework. In Muslim countries, Islamic banks are able to get some concessions; in other countries, they are not. So this is one of the major problems which Islamic banks face.

I did mention in my lecture the issue of books of instructions. Various banks have instructions for their employees. The international associations for Islamic banks have also published a series of manuals which are available. The State Bank of Pakistan has issued Pakistani banks with very detailed manuals giving instructions on various issues. The United Bank of Pakistan has also published two, large manuals. I am sure that there are many others which are available.

As to the appropriate atmosphere of honesty, it again comes to the same thing. Yes, there is the problem of hazard but, as I mentioned, if the banks have the courage and they go to the businessman, they also have a just interest. They cannot cheat; if they cheat once they, will not get the financing later on. Banks should have a centralized list of cheaters and they should blacklist them. In this way they will put more pressure on such businessmen and, of course, they will try to avoid and monitoring. We should mention that banks may also resort monitoring, auditing and accounting.

As to how to deal with conventional banks in London and Tokyo, elsewhere, I would again like to mention to brother Tajul Islam that even those

banks are willing to work on the basis of Islamic principles. I know from my experience as an economic advisor to Al-Rajhi Banking and Investment Corporation which has a branch in London and in Tokyo and an *office* in London and in Tokyo, that we were dealing with a number of non-Islamic conventional banks on the basis of Islamic contracts. We drafted contracts with them by mutual negotiations. We agreed on certain contracts which were approved by the *Shari'ah* board of the Al-Rajhi Banking and Investment Corporation and the conventional banks were operating on the basis of those contracts. We these kind of we have to be aggressive with these banks. If we need them, they also need us. They need business and fortunately there is a lot of business in Islamic countries especially in the Gulf states. There is a lot of interest in this market and we should utilize that interest and negotiate with them There banks very, very strongly. We did it in the case of Al-Rajhi Banking and Investment Corporation and the contracts on the basis of which we worked with those banks were approved by the *Shari'ah* board of our bank.

**Question: Hasan Mukhtar from Sudan**

The speaker mentioned the misuse of the Islamic methods of financing in at least two cases in Pakistan. In Sudan we have many misuses of this methods of financing. The *Shari'ah* boards in these banks are supposed to approve the contracts for this method of financing. The bank is free to choose anybody to be a member of the *Shari'ah* board. Is there any method for making the central body control the financing of these banks? More especially, I want to know how we can control foreign banks in a country that has Islamized the whole system of banking. For example, we have a Citibank in Sudan reporting that it has had more profits with the Islamic method, of financing than with the rate of interest. This is actually a misuse of the Islamic methods of financing to get more profits than the rate of interest. The other question I have, what is the role of the central bank when the banking system has been Islamized. Thank you.

**Dr. M. Iqbal**

First, let us look at the misuse of Islamic modes of financing. Yes, there is some misuse of Islamic modes and I mentioned then myself. I am sure there may be such misuse in Sudan as well. The point that you raise is very important. Many banks have *Shari'ah* board which is supposed to supervise the operations of the bank, and which is selected by the bank management. This is an incorrect procedure. I fully agree with you, that this is wrong. In one case I know, again

regarding the organization for which I have been working for the last two years, Al-Rajhi Banking and Investment Corporation, the *Shari'ah* board was selected or elected by the general body. In this way they have a higher position than the board of directors and that position enable the *Shari'ah* board to control and monitor the activities of the bank, and as I mentioned, even in dealing with conventional banks like Citibank and others, they were able to negotiate in such a way that the bank could not finalize contracts until the *Shari'ah* board approved them. So one suggestion which can be made is that the *Shari'ah* boards of Islamic banks should be elected by the general body rather than selected by the management itself.

The other possibility could be that there should be a centralized *Shari'ah* board for all Islamic banks.

As far as the role of the central bank in an Islamic economy is concerned, its role is the same as other central banks, that is, the controlling of the money supply and ensuring the stability of the value of money. Now the way it performs its role is different in the Islamic system than in the conventional system, because one or two types of monitoring control are not available to the Islamic central bank, that is the discount rate and open market operations. However, there are a number of other tools which are available to the central bank in an Islamic framework: Credit limits, control of profit margin ratios, liquidity ratios and all other conventional modes of control of money supply are available to the central bank as far as the open market operation is concerned. They can have open market operations in equities and in *Mudaraba* certificates which can circulate in an Islamic economy.

Therefore, there are number of tools which are available to a central bank in an Islamic economy and the role of the central bank is the same: controlling the money supply and ensuring the stability of the value of money. These are the most important and then, of course, in underdeveloped countries, they add the role of development and the distribution of credits, etc.

### **Question**

What is the basic principle generally followed by Islamic banks in distributing profits?

**Dr. M. Iqbal**

The principle is the same as there has to be a preagreed ratio of profit sharing between the depositors and the banks. This ratio varies from one bank to another. Whatever the actual profit is, the banks keep some profits as reserves on distributed profit which is normal. Other banks and companies keep undistributed profit that is decided by the management of the bank's board of directors and the rest of the profit is distributed to the depositors on the basis of a preagreed ratio in the proportion of money utilized by the bank on a daily product basis.

**Question**

You spoke of advancing loans to producers, but nothing has been said about advancing loans to consumers. If there is any existing society consumer credit Islamic banks can easily advance it on a profit-sharing basis.

**Dr. M. Iqbal**

Yes, Islamic banks advance loans to consumers on the basis of Murabaha. The same thing can be applied, for example, if somebody need a loan in order to buy an automobile. The bank will purchase an automobile for him and sell it to him at a higher price. The price will be paid in installments over a period of time. This is one example of consumer credit, and there are others too.

In the case of house finance, for example, there is one model being used by the House Building Finance Corporation of Pakistan, which advances loans on the basis of rent sharing. The person contributes whatever money he can and the rest of the money is given by the House Building Finance Corporation. They fix the rent of the house, and when it is completed the Corporation gets a share of the rent according to the contribution that it made. The owner/partner pays a little bit more, and the increment is his contribution towards full ownership of the house. So gradually he increases his ownership and the ownership share of the House Building Corporation goes down and accordingly, the rent also goes down. After a certain period of time, he becomes the full owner of the house and he does not pay any interest thereafter. Thank you.

Thank you, very much, bother Munawar Iqbal for presenting a good paper and for answering questions from our participants and observers. I also thank all the participants and observers here for taking an active part in the seminar. Thank you all. With this we end today's sessions.

***CHAPTER TWENTY***

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# **ZAKAH AND OBLIGATORY EXPENDITURES IN ISLAM**

*Monzer Kahf\**

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The objective of this lecture is to present a general view of *zakah*, which alone usually requires a full course and other expenditures on individuals in a Muslim economy and their economic effect.

Everybody knows that *zakah* is an act of worship on the part of its payer, a relief for the unfortunate segment of the society, and since it is collected and distributed by the government it is also a tax/expenditure. This is one of those unique characteristics of the Islamic economic system that *zakah* is made the third pillar of Islam while it is a financial duty and a relief transfer. From the beginning this perhaps shows the comprehensiveness of the Islamic economic system, where you find economics interwoven with ethics, values and spiritual rituals. This doesn't apply to *zakah* alone but to all other aspects of Islamic economics. For instance, one finds talking about the behavior with regard to money and income mingled in early revelations sent down to the Prophet Mohammed (Pbuh) with the essentials of faith. Hence, as early as the fourth *surah* of the *Qur'an* in the early days of Islam in Makkah, there was a condemnation of the behavior of the Makkan society with regard to economic practices and transactions. Alternatively, *surah* 4 suggests that economic behavior of men and women must be linked or related to the belief in the Hereafter so that the time horizon in the Islamic rationalism has a longer or infinite limit. Those famous verses of *surah al Mutaffifin*, No. 83 of the *Qur'an*, clearly indicate that the economic behavior of men and women is intimately related to their faith (or lack of it) in God and the Hereafter.

Moreover, the presence of *zakah* and its position in Islamic religion tell also one of the characteristics of the Islamic system that its ingredients are always given moral support and spiritual impetus; they are interwoven

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together that they can hardly be dismantled. You cannot separate the Islamic economic system from the moral system of Islam, from its rituals and *ibadat*, from the social system and political system, etc. All of the sub-systems are interwoven together, that you cannot separate one from the other.

*Zakah* was made obligatory in the second year of *hijrah*. It is mentioned in the *Qur'an* in 28 verses using the term *zakah*. There are other verses that use the term *sadaqah* in the meaning of *zakah*. These include the verses of *surah No. 9 (surah al Taubah)* that talks about the application of *zakah* and provides the most detailed *Quranic* instructions of its collection and disbursement, specifically, these verses use for *zakah*, the term *sadaqah*: "take, out of their *mal*, a *sadaqah*" and "*sadaqat* are only for the poor and the needy (verses 60 and 103).

Thus, as a worship, we know that *zakah* is the second practical pillar of the Islamic religion. But, *zakah* is also a tax on *mal*. The word *mal* is an inclusive term of wealth and income. According to the norms adopted by Muslim scholars, *zakah* is levied on items of income and wealth; we find this with no exception in all schools of jurisprudence. The most classical or conservative views would say that as mentioned in the sayings of the Prophet (Pbuh), *zakah* is imposed on agricultural produce which is an income by our definition, and on cattle, camels and sheep, that are mostly assets, or stock of wealth but they have also an income included in them. *Zakah* is also imposed on trade merchandises and, like livestock, these assets also include both income and wealth. *Zakah* is also imposed on gold, silver and money which are all stock items. So, even the conservative views ascertain that *zakah* in *Shari'ah* is levied on items of wealth and income. Other views see in *zakah* a tax on salaries, profit, rent, earned income and all items of assets.

Looking at *zakah* as a tax on income and wealth, there are different views among Muslim scholars, these can be classified reasonably in three categories:

A) The classified view, which considers *zakah* applicable only to four items :

1. money, including gold and silver,
2. business tradable items which are mobile or liquid,



3. livestock which includes the increase that takes place during the year, in our terminology today, like business tradable items, this *Zakahable* item includes a stock and a flow, i.e., partly income and partly wealth,
4. the agricultural produce which is all an income items in contemporary terms. With regards to the details of *Zakahable* agricultural products, there are several opinions, but, I think those views may be given in details in an under-graduate course, where we look into the rulings of *Shari'ah*, what are the **included** items, what are the exemptions, etc.

B) The second opinion is very much represented by Shaikh al Qaradawi, who is one of the most renowned Muslim scholars in the world, specially in issues related to the introduction of *zakah* in a modern context. It was his Ph.D. dissertation that started in 60's and finished in the early 70's that talks about the *fiqh of zakah*. It is published in a two-volume book, about 1100 pages. It states in details the different aspects of the Jurisprudence of *zakah* from a to z. Yet, he expressed many new views compared to the classical jurists, but at the same time, one may still have many differences with him on several issues. According to al Qaradawi, two important items are added to these *Zakahable* items

1. income from labor, any kind of labor, professional, salaried, or non-salaried services;
2. return of real estates and other fixed assets.

These two points fairly characterize al Qaradawi's view, namely: the inclusion of labor income and the inclusion of return on real estate and other fixed assets in the *Zakahable* items. He adds that return of fixed assets is *Zakahable* of the rate of either 5% on gross revenues or 10% on net revenues.

C) There is a third opinion which is becoming more popular among the younger generation of *fuqaha'* although it has become more common over the last decade among the Muslim economists. In a recent seminar discussing *zakah* held in Cairo, 1988 under al

Azhar sponsorship, there were several voices among Muslim scholars in favor of this opinion. This opinion looks at all items of wealth and income and gives a blanket coverage that all items of **wealth** and income **should be included** in *zakah* keeping in mind the normal exemptions of personal items. In other words, this opinion considers all the net worth itself as *Zakahable* since the *Qur'an* says "take out of their *mal*", and *mal* includes every thing one owns. Moreover, many sayings of the Prophet (**Pbuh**) talk about *zakah* "to be taken from the rich" regardless of whether he or she is rich in terms of income or in terms of wealth. The essential implication is that fixed assets, real estates, any other stock are to be included in *zakah*, *i.e.*, such items are *Zakahable*, whether they have a return or not, and if there is a return, whatever is added to the asset as an increment, out of that return is also *Zakahable*. So, actually they take the opinion of al Qaradawi and modify it so that not only return on fixed assets, but also the fixed assets themselves, become subject to *zakah*.

### **Application of *Zakah* in the Muslim World:**

Many Muslim countries have issued laws for the implementation of *zakah*. These include Malaysia, Bangladesh, Pakistan, Kuwait, Bahrain, Qatar, Oman, Saudi Arabia, Jordan, Libya, Sudan, and Yemen. In some of those countries, *zakah* is not made obligatory, *i.e.*, it is to be paid voluntarily to a government organization established by that law. This is the case in Kuwait, Bahrain, Qatar, Oman, Bangladesh and Jordan. In some other countries, *zakah* is made obligatory ; it is to be collected by the power of law. This obligation exists today in five Muslim countries. Sorted in a historical perspective they are: Yemen, Malaysia, Saudi Arabia, Pakistan and Sudan.

The coverage of *zakah*, however, differs from one country to another specially among those five countries. Whenever *zakah* is paid voluntarily to a governmental institution, then you don't talk about coverage, because a person will come and pay any amount he /she likes and says this is my *zakah*; and there is no sense of talking about what are the items covered by *Zakah*. In those five countries, the coverage of *zakah* does matter because the *zakah* institution is required to collect it. In Pakistan for instance, *zakah* covers basically two kind of items, financial assets and agricultural produce. It does not cover livestock, current account in Bank, tradable merchandise or cash in hand. In Saudi Arabia,

*zakah* covers more items than in Pakistan. In addition to the items mentioned above, it also covers movable part of business assets. On the other hand, *zakah* in Saudi Arabia, covers cash in Bank and in hand, i.e., current account in Bank as well as cash on hand provided they are part of business assets, but these items will escape *zakah* if they are owned by a person who does not have a business. Probably Sudan has the most comprehensive law of *zakah*, among the above mentioned five Muslim countries. *Zakah* covers practically all items of wealth and income including salaries and other labor income.

One should not also forget to mention the *zakah* on persons or on individuals, i.e., *zakah* per head which is called *zakah al fitr*. It is a branch of *zakah* mentioned in the sayings of the Prophet (Pbuh) as an obligatory duty, a small amount of food, once per year, at the end of the fasting month of *Ramadan*. This may be called *zakah* on persons in contrast to the *zakah* on *mal*.

The rates of *zakah* vary depending on the nature of the *Zakahable* item. Sometimes the rate is 2½%; this applies to assets including money, tradable merchandise, livestock, salaries, etc. There is also a 5% rate for the agricultural produce which is watered by digging wells and extracting water by use of animals. The *zakah* rate may also be 10%. This applies in the case of agricultural products from rain or river fed lands. Finally, the rate is 20% for found treasures and minerals exploited by private parties.

The exemptions of *zakah* are mentioned in details in jurisprudence books. The first exemption relates to public funds and revenues, i.e. all public assets, properties and revenues are not subject to *zakah*. This is on the basis that public properties and public revenues are themselves to be used to serve the interests of the whole society; on top of these interests comes the welfare of the poor and needy which is the main objective of *zakah*. Additionally, *zakah* is an individual act of worship that cannot be performed by non-natural persons.<sup>1</sup>

The second exemption from *zakah* relates to assets appropriated for philanthropic and/or religious purposes such as the philanthropic *awqaf*. This includes mosques, charitable institutions and other institutions that are not privately owned. The same rationale of exemption of public funds applies here too.

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1. It is known in *Shari'ah* (the Shafi'i school of jurisprudence) that *zakah* may be taken on mixed items. Mixed items are defined as items owned by more than one person, but that does not mean that the *zakah* is not personalized.

The third important exemption from *zakah* relates to non Muslims living in the Muslim society. As *zakah* is an act of worship and a pillar of the Islamic religion, non Muslims cannot be asked to practice the Islamic rituals on the basis of the Qur'anic verse indicating that "there is no compulsion in religion". However, some Muslim scholars argue that whenever the exemption from *zakah* of non Muslims living within the boundary of the Islamic states creates unjust distribution of income and wealth in the society and effects wealth to flee to the hands of non Muslims, a *zakah* equivalent tax must be imposed on non-Muslims which should be devoted, like *zakah*, to social relief activities of the non-Muslim community in the Muslim country.

The fourth important exemption from *zakah* relates to personal effects and needs. By means of several sayings of the Prophet (Pbuh) indicating that *zakah* is a financial duty on the rich and that the poor is exempt from *zakah*, especially that the poor is a recipient of *zakah*. This itself means that there is an exemption from *zakah* on the basis of poverty. Consequently, all those whose income is merely sufficient to fulfill their necessities and needs must obviously be exempt from *zakah*.

However, the Prophet (Pbuh) also established a yardstick for this exemption. This is owning or having as a remainder after personal and family expenses, an amount of 20 dinar or 200 dirham<sup>2</sup>, this exemption is called *nisab*.

### ***Zakah and Taxes***

The main characteristics of *zakah* are the following :

1. It has fixed rates that cannot be changed because they are religiously sanctioned by Divine revelation.
2. *Zakah* is permanent in a sense that it is levied on the rich every year as long as he/she owns the *nisab* above expenses on personal and family needs. Its levy and collection is not related to the needs or circumstances.

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2. This applies to gold, silver and money as well as other items of income and assets. With regard to agricultural products, the exemption limit is 5 *wasq* (equals 653 kg) and with regard to livestock, the exemption limit is 5 camels, 40 sheep or 30 cows. All these amounts came in authentic sayings of the Prophet (Pbuh).

3. *Zakah* has a moral and spiritual support derived from the fact that it is made the third pillar of this religion.
4. *Zakah* is a kind of designated revenue for the government that must be spent for certain purposes and cannot be used for any of the government's general activities.

These characteristics imply that *zakah* is unique among all forms of taxes that used to be collected at the time when Islam began in the Arabia. It is a due on a person simply because he/she is financially capable Muslim. It represents an internal mechanism of adjustment by continuously transferring wealth/income from the rich to the poor.

### ***Zakah as a Relief***

*Zakah* may be the first known institution in the world established for relief purposes that is permanent in nature. The *Qur'an* justifies its collection by being a means of purifying and sanctifying the *zakah* payer in specific and the whole Muslim society at large. Hence, although it is used basically for charitable purposes, it does not have the demeaning effect on the poor a charity might usually have, as it is an obligation on the rich and an act of worship on the riches' part in contrast to being a mere benevolence or charity.

On the other hand, *zakah* is a right of the poor. It indicates that the Islamic economic system recognizes the inadequacy of the "hidden hand" in any economy. Freedom of economic behavior does not always produce economic satisfaction of the needs, even the basic necessities, of everyone. Someone may be left behind or may fall short of fulfilling one's basic necessities. Yet, survival and adequacy in needs fulfillment is a personal sacred right of every person. *Zakah* in this regard represents an internal mechanism that works within the Islamic economy on a permanent basis to re-balance the distribution of wealth and income, so that wealth would not only be circulated among the rich alone as expressively targeted by the Qur'anic verse No. 59:7.

Although *zakah* is meant essentially to eradicate poverty, Qur'an (9:60) mentions eight categories whereby *zakah* proceeds can exclusively be spent. The Prophet (Pbuh) in an authentic saying also emphasizes that God has stipulated in the Qur'an the categories of potential recipients and no one can make any change in these recipients. In a sense that it is not lawful to give *zakah* to anyone outside these categories. The categories are: the poor, the needy,

workers in collection and distribution of *zakah*, people under burden of debt, helping freeing slaves under bondage, reconciling hearts and softening them towards Islamic religion, wayfarers and in the cause of God.

Obviously these categories cover all aspects of social welfare in addition to providing for self support of the *zakah* institution itself.

### ***Zakah* and Public Finance**

From the previous description, it becomes apparent that *zakah* cannot be used for financing regular and developmental activities of the Government. Even the expenditure heading of "*fi sabil Allah*", i.e. in the cause of God, which is sometimes thought to be general, does not cover regular expenditures of the Government. Most Muslim jurists interpret this item as covering only support of voluntary fighters who defend the Muslim lands, people or religion. This is so because the term "*fi sabil Allah*" is used very often in the Qur'an to mean fighting in the cause of God (*jiḥād*).

Being prevented from using *zakah* to finance Government activities, the main revenue for financing Government activities must come from other sources. This is perhaps why the Prophet (Pbuh), as early as the 4th year of establishing the Islamic states, put aside some agricultural lands to be used as a public property, producing revenues to the Government. These were the seven palm-tree orchards inherited by virtue of the last will of *Mukhairiq*. This practice was later expanded when Khaibar was open and became the major source of public revenues upon opening the lands of Syria, Iraq, Egypt and Persia during the years 11 to 21 of *Hijrah*.

With or without public property as a source of public revenues, as question remains outstanding whether taxation is permissible in Islam. Because there might be circumstances in which either the *kharaj* (rent of publicly owned land) does not exist or the Government expenditure plans are more than what can be supported by *kharaj*.

Moreover, it is historically known that Muslim Governments, in many areas of the Islamic world, imposed several kinds of taxes. On the other hand, Islamic scholars in their discussion of permissibility of taxation did not raise an objection that *zakah* may at any time be used to support Government activities. In other words, it has always been recognized that there ought to be sources other than *zakah* to finance the functions of an Islamic Government.

In a contemporary context, many Muslim scholars consider taxation as indispensable in many Muslim countries. The only exception may be those countries with huge natural resources and small population. However, it has always been the case that Muslim scholars, present and past, always consider *zakah* as a standard or norm in designing taxation, i.e. very often taxes devised by Muslim scholars would inspire *zakah* provisions.

Hence, the principles of taxation that are borrowed from the *zakah* system can be presented as follows :

1. A tax must only be imposed on the rich and in accordance with their richness (wealth and income).
2. Direct taxation are preferred over indirect taxation.
3. The taxation system should always provide for exemption of adequate personal level of living.

### **Distributive Effect of *Zakah***

Contemporary Muslim writers have several essays on the distributive effect of *zakah*. Obviously, since *zakah* is essentially a transfer payment from the rich to the poor, it must have an explicit distributive effect. However, the eradication of poverty from the Muslim society by means of *zakah* depends on the size of *zakah* proceeds as well as the severity of the poverty incidence in a Muslim community. Historically, we have reliable reports that poverty elimination became a reality in certain provinces in the early period of the Islamic religion. This is reported in Yemen during the time of the second Caliph when over a period of three years the total yearly proceeds of *zakah* in Yemen could not finally be used because there was no need for it, and it had to be carried over to the Central Government in Madinah. Once more, during Omar Bin Abdulaziz at the turn of the first century of *Hijrah*, Egypt could not use all of its *zakah* proceeds as there were no poor people to accept it.

In a contemporary context, the proceeds of *zakah* depends on several important variables: the distribution of wealth in the Muslim country, the level of income and prosperity, the relative contribution of the private versus the public sectors to wealth ownership and income, the efficiency of the management of *zakah*, the comprehensiveness of *zakah* regulations with regard to *Zakahable* items of wealth and income, etc.

It is interesting to observe that the actual collection and distribution of *zakah* in the five countries that, one way or another, established *zakah* on an obligatory basis is not sufficient to eliminate the incidence of poverty. For instance, in four countries (Saudi Arabia, Pakistan, Sudan and Yemen), the total annual proceeds of *zakah* could not reach 0.3% of GNP. This is obviously way below the level of transfers required to eliminate poverty which is, for instance, in Pakistan about 4% of GNP.

Looking into the jurists' opinions with regard to *Zakahable* items as classified into three categories earlier in this lecture, one may easily realize that the classical view about *Zakahable* items produces the lowest proceeds of *zakah* compared with the Al Qaradawi view and the more modern view. And apparently the modern view is the most comprehensive and the most productive in terms of *zakah* revenues.<sup>3</sup> Therefore, the choice of *the fiqhi* opinion would have an important bearing on the ability of *zakah* proceeds to eliminate the incidence of poverty in any Muslim country.

On the other hand, *zakah* is not the only tool to eliminate poverty in the Islamic system. We will talk later about other obligatory expenditures in *Shari'ah*, but, in the meanwhile, it should be emphasized that productive work and development is the essence of any program of poverty elimination.

### **Collection and Distribution of *Zakah***

The Qur'an made it clear that *zakah* collection and distribution is the responsibility of the Islamic Government. Verse 9:103 clearly ordains the head of state, who was at the time of revelation the Prophet Muhammad (Pbuh) himself, to "take out of their *mal a sadaqah*". The Prophet (Pbuh) appointed *zakah* collectors and distributors in the different areas of the country which covered the whole Arabian Peninsula by the end of his life.

Islamic jurisprudence provides for an autonomous *zakah* treasury within the Government organization (*bait mal al zakah*) because *zakah* proceeds should only be spent on the eight categories of expenditures as mentioned above. This practice remained in the Muslim land until the latest days of the Ottoman

3. In another study, I compared these three views if they were applied in eight different Muslim countries and the result was that proceeds according to the classical view would be approximately 1 to 1.5% of GNP while they would be between 4.5 and 7% according to the Al Qaradawi opinion and between 5.5 and 8% according to the modern opinion.



Empire and it remained until today in Yemen. In most Muslim countries, the government relieved themselves of their responsibility toward the collection and distribution of *zakah* until early 50s of this century when it was reinstated in Saudi Arabia by a Royal Decree.

However, it happened historically that with the spread of dictatorship and the lack of political legitimacy and moral confidence in the rulers in parts of the Muslim world, Muslim jurists as early as the beginning of the second century of *Hijrah* developed a tendency toward preferring self disbursement of *zakah* by the *zakah* payer. Hence, we find Imam Ibn Hanbal (Sirca 241 H) preferring that whoever owes any *zakah* should personally distribute it to the poor and needy rather than giving it to the Government collectors.

However, Muslim scholars do not have any disagreement on the point that if, for any reason, the Government fails to collect and distribute *zakah*, individual *Zakahable* persons must take charge of spending their own *zakah* to some or all of the potential *zakah* recipients as mentioned in *Qur'an*. Recently, many voluntary charitable organizations were established throughout the Muslim societies and communities to collect and distribute *zakah*. This provides a reasonable alternative which fills the gap of the absence of this function from among the Muslim Governments' activities.

### **Economic Effect of *Zakah***

There are several studies on the economic effect of *zakah*. Some Muslim economists argue that by virtue of the distributive effect of *zakah*, aggregate consumption should increase. This is obviously based on a Keynesian consumption theory in which consumption grows less than proportionally with the increase of income. This effect may not be true if one adopts a permanent-income theory of consumption or a life-cycle theory in which consumption increases are proportional to income growth. However, if one adds a condition of in-kind distribution of *zakah* proceeds, consumption must increase since the incidence of reselling the *zakah* received by the poor may be assumed minimum because of the cost involved.

Additionally, it may be argued that the introduction of *zakah* in a country should change the pattern of demand for consumption goods by shifting it more towards goods that fulfill the basic needs and away from luxurious goods because it may reasonably be assumed that most recipients of *zakah* would use it for the purchase of the first category of goods, basically food and

shelter, while most *zakah* payers would curtail their demand for luxurious goods as a result of the decrease in their income caused by the payment of *zakah*.

With regard to the effect of *zakah* on investment, the argument centers on three points

1. Whether *zakah* payment would induce payers to increase their investment in order to make up for the loss resulting from the payment of *zakah*.
2. Whether the basic structure of *zakah* in *Shari'ah* is designed to privilege investment by exempting fixed asset and real estate from *zakah*. This argument is obviously based on the classical view of *Zakahable* items of wealth and income.
3. Whether the increase in income of the poor which results from *zakah* receipts would increase aggregate consumption for the economy on one hand and savings on the other hand. Both effects would raise the return of investment while increasing funds available for new investment.

## OTHER OBLIGATORY EXPENDITURES

In addition to *zakah*, the Islamic system provides for additional re-distribution devices which support the effect of *zakah* in reducing the incidence of poverty. The most important among these devices are the following :

1. The concept of extended family coupled by the financial responsibility of the rich toward the poor in the family. This provides for family support to cover not only members of the small family consisting of parents and minor children but to include brothers and sisters, parents and grand parents, uncles and aunts and cousins and nieces. This coverage has different levels of obligations. It is obligatory on the rich family member towards parents and grand parents and the female members of the family. However, this obligation is relaxed with regard to the male distant relative and their support may even be done by using the *zakah* of the rich family member.
2. Obligatory expenditures also include the *kaffarat*. These *kaffarat* are compensatory payments obligated in case of committing certain violations of some of the rituals of *Ibadat as* in pilgrimage and fasting. What is important about them is that *kaffarat* in Islam are not to be paid to the church or the mosque or to any ecclesiastical establishment; they are pure transfer of payments that must be given to the poor and needy. Therefore, although *kaffarat* have spiritual source related to the rituals and worship in Islam, they are in fact obligatory charity given to the poor.
3. In addition to *kaffarat*, there are other obligatory expenditures based on social factors such as providing guests and strangers in town with necessary means of livelihood. This is made obligatory by virtue of several sayings of the Prophet Muhammad (Pbuh).
4. Finally, and perhaps most important, the concept of *fard al kifayah* in Islam which may be translated as collective obligation supplemented by individual responsibility. *fard al kifayah* means that there are certain social needs that must be fulfilled and their fulfillment is an individual responsibility of the capable members of the society who are individually responsible for these needs as long as they are not completely fulfilled by someone else and the moment someone takes care of these needs, others are relieved from that personal burden.

The concept of *fard al kifayah* in *Shari'ah* applies to many social requirements which include, as examples, providing a place for worship, a mosque, burying the deceased, cleaning the environment, defending people against epidemics and enemies, provision of drinking water, etc. *Fard al kifayah* concept provides for charging the rich with the cost of many social needs that are indispensable for the Muslim community. It represents the basis for a whole spectrum of obligatory expenditures in the Muslim society.

***CHAPTER TWENTY-ONE***

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## PROJECT EVALUATION AND TIME VALUE DISCOUNTING

*Muhammad Anas Zarqa\**

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I will address the question of discounting first because it is special, and I will then move on to the question of the criteria for project evaluation from an Islamic point of view.

Regarding discounting, we have to start by analytical distinguishing between two different concepts which are often confused in the minds of economics students. One is the rate of return and the other is the rate of interest on a loan. Now as long ago as 1936, Frank Knight, the well-known American economist, complained about what he called the terrible confusion two ideas together, that is, some people are under the wrong impression that the rate of return on an investment and the rate of interest on a lone are one and the same thing.

The word "confusion" should be clarified before we proceed any further. In fact, the words "terrible confusion" are not my own; they are Professor Knight's words. He says we should eliminate the "terrible confusion" which results from mixing up the rate of return on investment with the rate of interest on loans. So, let us suppose, for example, that we are thinking of an economy like Robinson Crusoe's economy: one person on an Island all by himself. Robinson Crusoe can calculate a rate of return on an investment he makes as the story goes. He can forgo eating fish for a couple of days and spend the time making a net which will help him catch more fish a few days later. If we go by the consumption bundle he give up now the grater consumption bundle he can get later on, we can calculate a rate of return on this investment activity.

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Even when you have this pure process of diverting resources from consumption into investment, you can calculate a rate of return. But you can do it in an economy like Robinson Crusoe's talk about a rate of interest? This does not make any sense for the simple fact that the rate of interest arises in a borrowing-lending relationship. It requires two people, not one person making an investment. You have to have party one advancing a loan and another party receiving it and then returning it later with a higher premium.

So the idea of the rate of interest is essentially a two-party idea, where the relationship between the two is a lending, whereas investment is a real activity. For an economy which is totally socialist, one can pose the question: Can you, in an economy which is totally socialist talk about the rate of return on investment? Indeed you can. and they actually do. You can apply the same logic as Robinson Crusoe. You calculate as cost the consumption forgone at present, and you calculate as return the extra consumption expected later. You work this out by the usual arithmetic process as a rate of return on a particular investment activity. Even though in a totally socialist system you may never allow interest. This happened, in fact, has in some socialist countries.

Unfortunately, a lot of economics literature helps create this confusion. The fact is that the rate of return is something that arises out of a real activity which is an investment, while another idea, which is the rate of interest, arises out of a lending-borrowing relationship. These are two separate categories of rates. An economist like Paul Samuelson for instance, has a book or monograph on capital and the rate of return which was pressed in The Hague and a series of lectures in which he again makes the very fundamental and central observation that the rate of return is a fundamental part of the real economy. Any economic investment generates a rate of return. Whether positive or negative, i.e., investment generates rate of return. Rates of return have nothing to do with the institutional arrangement of the economy. You may have a socialist economy, a capitalist economy, a one-man economy or any economy you can think of. For each such economy, you can calculate a rate of return for a particular investment.

However, in some economies you may or you may not permit the borrowing-lending relationship even though the borrowing-lending relationship is logical. So we must keep these two separate in our minds, and recognize that they are two ideas and phenomena.

Then, of course, we must not deny that in a particular society which permits a rate of interest and which engages in a real investment, there are interactions between these two economic variables. All economic variables, as we know, are interdependent, that is, everything depends on everything else. So any particular variable of the economy, directly or indirectly interacts with every other particular variable of that economy. Therefore, to say that the two rates are economically quite distinct is not to deny that they do interact. If society permits both of them to exist, they do interact.

I need not go into what economists have said about the interaction between the two, but I will mention just one thing. Joan Robinson addresses the question in one of her articles in fact in more than one. She asks whether rate of return is the primary phenomenon that affects the rate of interest, or is it the other way round? In her own mind, the answer is clear. She clearly states that in the long run the rate of interest will follow rather than lead the rate of return. The rate of return in the economy ultimately has to be followed by the rate of interest. Of course, you are assuming here a market economy without government interference.

Now in the present world where governments are big borrowers on a huge scale, they can borrow at rates which are not matched by the rate of return on capital. They can offer an interest rate to the public which is related to the rate of return that a businessman can earn from real investment. What I want to emphasize is that intellectually we have to differentiate between these two things without denying that they do interact in various ways.

Therefore, this matter should be clear. Let us intellectually come to the simple conclusion that it is possible for an economy to have rates of return on investment which are positive, while at the same time administratively creating a ceiling on the rate of interest which is equal to zero. Could we theoretically have an economy where you have a positive rate of return on investment and at the same time you have an administrative ceiling on the rate of interests? Is there possible contradiction between the two? As long as you have real investment going on in the economy, you have rates of return.

Now whether you allow people to lend and borrow at interest, is an entirely different question. It is an institutional arrangement. You may have it, or you may not have it. In that case real economic activity is not a legal contrivance. The following-lending relationship is a legal relationship between persons. You have to return the loan and then pay something extra which is



interest. So in fact we cannot spend much time on the issue, but at least let me state my conclusion. It is entirely feasible to have an economy where rates of return are positive and where the rate of interest is kept always at zero by administrative law-making actin. There is no contradiction between these two things.

Now we come to the question of permissible discounting as opposed to forbidden discounting. Let me reverse the order of discussion and explain what I mean by forbidden discounting. Discounting has two meanings in economics and commercial dictionaries. There is the discounting of bills of trade or of bonds. In this process discounting is basically conducted in the following manner. I have a debt against Mr. X. perhaps in the form of a bond or a commercial paper. I go to a bank and say that I will transfer the right to collect the amount from the debtor at the time of maturity if you give me now a smaller amount. This is the essence of discounting commercial bills. Now this kind of discounting is absolutely forbidden for (*Haram*) in Islam this is *Riba*. There can be no question about it and no economist can justify himself in saying that this is anything but lending at interest. However, this type of discounting is not at all what we have in mind when we talk about discounting in project.

In the first instance, you have connected discounting with one person having a debt and extending credit to another. He sells this loan for an amount to be paid now which is smaller than the sum to be paid later to a third party, usually a bank. This is interest financing without question, and it is clearly prohibited in Islam. This kind of discounting is not what we are talking about in project evaluation at all.

We are talking about the other concept of discounting which is very clear in economics literature. Let us call this forbidden kind of discounting: discounting related to debt, to the debtor-creditor relationship where you have loans. You collect a smaller amount now in return for a larger amount later. This a forbidden. This is based on interest, or *Riba*.

There is, however, the other entirely different meaning of discounting which is discussed in investment budgeting and in literature on the subject of project evaluation and investment theory. This other discounting is based on the following idea. If you have benefits and costs of a particular investment, they are usually spread over time in a different range of benefits and a different range of benefits and a different range of costs. You need to compare them. You can compare them arithmetically by adding up the sums. Economists show that if

you do so you can take investment decisions, but they are likely to be inefficient in terms of the following period. If you want to achieve some investment program over a period of time, we can show economically that you will sue up more resources. So economists emphasize that in comparing various investment opportunities, you may ignore discounting but you will do it at some loss of output, which Translates into inefficiency. This is the common meaning of inefficiency in economics. They say if you take account of the time dimension of a beneficent course, you can have a more efficient investment program in the sense of an investment program giving the same amount of output for less smaller amount of inputs.

Now this is exactly what we are concerned with in this lecture: the discounting whereby we compare prospective flows of benefits and costs. Are investment projects utilizing this kind of discounting permissible from an Islamic point of view? If they are permissible, what kind of rate of discount can then be used? Since we are assuming that in Islamic economy there will be a zero rate of interest by administrative decision, can we in such a society engage in investment using discounting and in this case what kind of discount rate do we want ? This is precisely what I want to discuss.

Let us, start with the technical position taken by economists. The present value of a prospective flow of benefits by a proper discount rate is one peace of information necessary for efficiency in investment. Now this technical fact logically forces as to accept discounting. Suppose that discounting is not permissible in the *Shari'ah*, in the second sense of discounting prospective cash flows. When the *Shari'ah* prohibits something, it is not necessarily on account of economic considerations it could be on the grounds of justice or some other social or moral consideration.

Every human society has given up some output to achieve some noneconomic goal. If your moral system says one particular activity should be avoided this particular activity could generate income, you forgo that income to uphold your moral system. We can all see that a lot of money is being made in several countries for producing narcotics. They can even make sure that they do not consume the narcotics; they send them to another country. Still everyone, including the government of the producing state knows that this is immoral. Then I am losing money by upholding morality. So why should I be so moral in banishing narcotics although I can make more money out of it and not banishing the rate of interest if by doing so it causes me some loss of output? Of course the answer is very clear: There is nothing economically rational about upholding

a particular moral system at the cost of some loss of output. So what I want is that we should not be forced to accept something just because it is more efficient. We agree that technically it will be more efficient to sue the discounting of prospective flows of cost and benefit of an investment. But is this acceptable from the Islamic point of view? We should not feel obliged to accept it; we have to use our minds.

Now I have devoted some time to this problem and my conclusion without any hesitation is the following. There is absolutely nothing in the *Shari'ah* to prohibit or to suggest that we should not sue discounting of prospective cash flows in project evaluation. There is absolutely nothing wrong in using discounting, and I mention in what sense or how we can carry out this discounting which is entirely legitimate. However, I underscore the fact that I am not arriving at this result because I feel that we are obliged to follow efficiency only. I say it on the grounds that it is *Halal*. Now if it happens that it also helps to increase efficiency that is good. But in essence I have tried not to rely on my own thinking in this matter. I posed a particular question to well known *Shari'ah* scholars. I posed the question of what is essentially best in discounting. I proposed the following example: Suppose I am a trader. In my own shop I am making on average a rate of return of about 10 percent per year. Some years it is more, some years less. But on average I make about 10 percent. Someone comes to me and offers me a *Halal* investment opportunity. He says we can buy a lot of land and plant trees and raise cattle. In this way an investment of one hundred riyals today will in three years yield one hundred and thirty Riyals. He asks me to participate in this investment.

I thought about it for a while and realized that if I invest this money in my own business, I will make on average 10 percent per year. In three years I will make more than thirty percent. So I told the fellow that the investment that he was suggesting was interesting, make more money in my own business. I asked two *Shari'ah* scholars whether there is anything wrong with this attitude. Is there any problem for me as a Muslim in rejecting this investment? In my view it is all right; it is *Halal*. The purpose of investment is also *Halal*. So we are comparing *Halal* with *Halal*; we are not comparing *Halal* with *Haram*. There is absolutely nothing wrong with this.

In fact, as you all know, discounting is nothing but this calculation more elaborately done. You have tables for it. Sometimes you have compounding; sometimes you have discounting, the reverse of compounding, but essentially, it is not more than that. You basically have several *Halal* investment projects. You

have a prospective rate of return in mind that you expect to get by some investment activity. Suppose it is 10 percent. In other words you will not accept any investment proposal that cannot exceed the 10 percent rate of return. This is what we do when we use this discounting cash flow method. So the conclusion is that there is absolutely nothing the *Shari'ah* to prohibit or to recommend against using discounting in project evaluation, as long as you are comparing one *Halal* project to another *Halal* project. This is the conclusion.

Now we come to a question which I have been asked by several brothers especially those who teach engineering. You know engineering students have a paper sometimes called engineering economy or capital budgeting. You say on one hand that interest is *Haram* and then you recommend the use of the compounds in these tables. What is more contradictory than saying that interest *Haram* and that the compounds in these tables are *Halal*? How can this be reconciled?

Now I had actually been expecting this question. Is this a valid objection? I think its objection is a misunderstanding. Suppose I want to measure the level this water and I sue a measure used usually for wine can you this say this is wine made from grapes, liquor, whatever. Does this water become *Haram* for me to drink because it has a level of wine in it? What in them that is the same? But sometimes we put a leverage and some one say no I don't like that. I believe it does not make any difference in the *Shari'ah*. The *Shari'ah* rules are best when they deal with reality not with names. What you call these tables is something of minor importance. What actually goes into the calculations is the important thing. Are you creating a lending-borrowing relationship where one party has extended the loan to another who pays more than that later on? If so, then this is *Riba* and it is *Haram*, whatever you call it. It is *Haram* because this borrowing-lending relationship was with a loan, and, therefore, it is *Haram*.

Now what you are doing in discounting is *Halal*. The fact that these tables are called compound interest tables makes absolutely no difference from the *Shari'ah* point of view. I know it is *Halal* but at the same time I do not like to argue any longer. Of course we have to recognize a mathematical fact: the formula on which the compound interest tables are based. This formula has absolutely nothing to do with economics. In fact it is a mathematical formula to express the flows to a quantity that grows uniformly over time. So this same formula has been used by biologists, economists and social scientists to describe the growth and decline of a population. It has been used by physicists to

describe the decay of material. Now the fact that one group of people who use this formula insist of putting a commercial label on it called compound interest does not charge anything. In physicist who uses it has nothing to do with interest. He is only using the mathematical formula. Of course that same formula is also used to figure out loans which are interest-based. So, this same mathematical formula can be used for several purposes, one of which is to calculate interest-based loans. Another is to discount cash flows for a project, a third for the physicist and a fourth for the biologist. It should be clear that we do not have to go by the shape of the formula. It is all mathematical- plus, minus, times, power and so on. Now those who engage in *Riba* also use the same arithmetic. Should we say that using this arithmetic is *Haram* because the people who are engaged in *Riba* use the same mathematical formulae? We go by the nature of the relationship. If you are engaged in a borrowing-lending relationship, then according to the *Shari'ah*, this is *Haram*. If you are using this compounding or discounting for a *Halal* purpose, then this is entirely permissible. So this in fact is the final conclusion. I would say that we should have absolutely no hesitation in using discounting of the project evaluation. We would prefer not to use this compound interest because it is like insisting on something which is repulsive. We can call them, which they are in fact, compound growth and decline tables. There is a continuous and discrete formula, but the essence of the thing is the same.

Now the question is: What rate do we use for discounting and for compounding when we engage in project evaluation? The answer is very simple. I will convey it to you in the words of the well-known economist Rober Dorfman. He published monograph a long time ago. I think it was on prices and markets in which, he has the following statement that what we should use for evaluating prospective investment is a rate of return that represents the opportunity cost of investment. This is the return of an alternative other investment project that is roughly of an equivalent degree of risk. If you find an investment that has a similar degree of risk, the return you expect on that investment is your opportunity cost. That is the elementary economic concept. So Dorfman says the opportunity cost of venture capital which is really investment is what the firm will earn if it invests venture capital in some other firm. So, in some investments the answer is very simply that any rate of return available in Muslim society out of renting assets, engaging in an investment or trade or whatever. This alternative rate of return is your opportunity cost and you can use it validly to discount the cash flow of that particular investment. You can consider it so. This is what I want to say regarding the question of discounting.

### Islamic Criteria for Project Evaluation:

I move on now to the matter of the second part of this lecture, which is the Islamic criteria for project evaluation. There will not be much time to elaborate on this, but will be as fast as I can. First, I must underscore one thing. These criteria are my personal understanding about the *Shari'ah* guidelines which are most relevant to investment. Please do not consider this to be a closed lists, as I am sure that everyone takes into consideration the conditions of his own country. He may come up with a different list, but these criteria are indicative. For each one of these criteria, you have a number of *Shari'ah* rulings to support it. It is not just a list that I hurriedly put together. Indeed, I tried to survey by induction various *Shari'ah* rules and then find the most relevant to investment. So this list can be shortened or lengthened, and it need not be the same for every Muslim country. Every Muslim country has certain constraints which may not be prevalent in another country. so each country may add certain criteria which are important from an Islamic point of view.

The first criterion is choosing the goods to be produced by a particular investment according to Islamic priorities. We have a general understanding of the objectives of Islam. Islam has a model for social and private life. Now the guidelines of this model are the *Shari'ah* rules, but for any particular time and place, we can translate the general *Shari'ah* guidelines into a specific list of preferable a given country and place. When you have this general survey of the *Shari'ah* and you also have a survey of a particular country, intelligent people can easily come up with a list of what they consider to be priorities. For instance, can a country which has widespread malnutrition and purchases food, export that food? Is it a high priority? Another country which is facing external threats and may be eliminated from the map may find that some defense activities are an extremely high priority at home at a particular time. So Islamic priorities would have no translate into the situation of a particular country and place. When this is done, and this is an intellectual exercise, people can engaged group of Muslim scholars on Islamic *Shari'ah* and a group of economists and social scientists and they can come up with a list of priorities for any country. This list would be a different formula for another country even though both are guided by the same Islamic guidelines. -So the first criterion for project evaluation is to ask if this project is contributing to those goods and services having the highest priority form Islamic point of view. So this is criterion number one. Of course, you may say that this is a qualitative criterion and you may ask how I can quantity it. This is very easy. We all know that for development and there are various ways to express your preferences. If you feel,

for example, that for Bangladesh product "X" is extremely important and product "Y" is less important, you may give the first product a weight which is higher than the second. This process is subject to *Ijtihad*, but the important thing is that you have to have a weight to express the intensity of that particular importance.

The second criterion is the generation of plentiful and convenient income for the largest number of people. This criterion is very well established in the *Shari'ah*. We know that in the *Shari'ah* every human being has the duty to support himself and his dependents. This is a personal duty. I am personally reacquired to support myself and my family. This is a fundamental *Shari'ah* duty. Now if you help Muslim, you perform a personal duty. This is very desirable. Suppose I do not have clothes to cover my body in order to perform prayer. You may provide me with clothes not necessarily by means of a gift. Suppose you provide me with work instead so that I can buy my own clothes. Then you are helping me perform a religious duty and this is a desirable thing. So generating income for the largest number of people is desirable without any question from an Islamic point of view.

Now in Islam there are justifications for preferring more income to less income and for preferring more convenient to less convenient income. One of the easiest ways to express the idea of convenience of income is to deduct from gross income the cost involved in obtaining it. You are coming very close to something, perhaps I would say that it is not identical, but very close to value added. You deduct cost to arrive at something which measures the surplus of income over cost in a certain sense. So we attach preference to more real income over less and to more convenient real income over more difficult to obtain real income.

One important matter under the second criterion is to recognize that in Islam all goals have graduate levels. For example, in the case of prayer, there is "*Fard*"; beyond that there is "*Sunnah Mu'akkadah*", less than that is "*Mustabah*" and then there is something which is one-week "*Mustahab*". This is true not only in prayer but in everything. In spending money there is the minimum compulsory "*Fard*" which is *Zakah* and then there are other ways of spending in the way of Allah which are less and less mandatory as you go along the line. This is applicable to all Islamic rules. consequently, as we all know, the level of income Islam wants every individual to have is not fixed. Islam definitely give a much higher priority to necessities, such as, helping the person to preserve and beyond that being able to acquire the necessary things that Islam wants every

individual to acquire- preservation of self, mind off spring, wealth, intellect and other desirable things. So achieving a level of income. Where you are able to sustain at least these basic things has a very high Islamic value.

When we go beyond these necessities to something less important, we enter the area of convenience. It is desirable, but it has a lower priority. We can take this social idea of graduation in desirability of the real income of each individual and combine it with the following example. Suppose I have two projects. One project can generate one million monetary units of wages but the labor force in that project is one hundred. Let us suppose that we are ignoring other factors of production for the time being. I have another identical project using different technology, perhaps using less skilled labor, more unskilled labor and less machines imported from outside. This project will have double the number of workers producing the same output, so the same wage bill is divided over a larger number of less skilled people. A question is poised from an Islamic point of view: Can we see these two projects as equally desirable from the point of view of this single criterion, i.e., the second criterion? As far as my own understanding is concerned, there can be no hesitation in answering. A project that provides income to a larger number of people has preference over an other project which provides higher income to a smaller number of people. This follows inescapably from the idea that you have necessities having high priority and then convenience and the luxuries. This follows logically for me and I would definitely say that 'this second criterion will create in the project evaluation a bias towards spreading income over a larger number of people.

Of course, it is not the only criterion from an Islamic point of view. It is one of the criteria. Consequently, I cannot say whether I will always, a Muslim, prefer a less capital-intensive project or a more capital-intensive one. I would say if other things are equal that I would prefer a project which provides income to a larger number of people if other things are equal. now other things may not be equal. You cannot have a labor-intensive oil refinery. it is capital-intensive; no matter how much you might want to make it labor-intensive, you have a certain limit. If you insist on labor-intensiveness, then you have to go to very elementary matters which are so inefficient as to be undesirable. So this is one criterion.

The third criterion combines poverty and improving the distribution of income and wealth. I need not convince you that this is a desirable Islamic goal, but I will call your attention to the fact that there is such a criterion in the heart of human beings.



Let us now try to introduce some specific technical ways of implementing this particular criterion in the project evaluation process itself. I need not go into technicalities, but, briefly, one simple way is to go for the income generated by the project, the cash flow. You try to figure where production is going, and when it goes to people who are supposed to be poor, you give it a higher weight. So you create in the project evaluation process a bias towards income going to poor people and in this way the project evaluation process helps reduce poverty. So there are a lot of ways to express this criterion in the actual evaluation process.

Preservation and the growth of wealth is one of the major desirable things in the *Shari'ah*. We know from Gazali, Shafei, and many other scholars that the preservation of wealth whether individual or collective is one of the major desirable things in the *Shari'ah*. In fact, there is a very interesting expression used by the Qur'an. The Qur'an refers to man in one of the "*ayas*" of *Surat Al-Nessaai* "Do not give the people poor of judgment the wealth that Allah has made a "*Qiaman*". It is meaning is important. Now Allah describes wealth as a mainstay of the human being. Now you look at the "Ka'ba" Allah Subhanaha wa ta'ala says 'He made for you al Bait of *Haram* (Ka'ba) *Qiaman*". Now look at the Mufasssine all describes *Al Bait al Haram*, Al Ka'ba using the same word used for wealth: "*Qiaman*". Now the *Mufasssir* say it is "*Qiaman*", it is a mainstay for the spiritual support of human beings. So Allah is using the same word as a support for living wealth is a mainstay for living. This is wealth. For the spiritual existence of man, the word applies to the Ka'ba. So, clearly Muslim scholars have said that if the human being is deprived of wealth, the<sup>y</sup>. he will be in a state of destitution. Allah wants Bani Adam to be honored not to be ruined, crushed and deprived.

Consequently, we should clearly emphasize that the preservation of personal and social wealth is a very desirable goal: not only the preservation of existing wealth but also the growth of that wealth. The more you obey it the better. So this idea of the growth of wealth being desirable has one immediate translation: priority valuation. You all know, those of you who have been engaged in actual project evaluation, that this is one of the techniques suggested by the UNIDO guidelines for project evaluation. They suggested technical ways building into the project evaluation process a certain bias towards the cash flow that is expected to be reinvested versus the cash flow which is expected to go into consumption. that portion which is expected to be reinvested in growing higher. This serves the idea of growth of wealth in projects if they are equal on other respects. The cash project with the cash which will be reinvested is given

preference over another project where most of its will only go into consumption. so, there are always means of implementing this in project evaluation.

Finally, we have the matter of the fifth criterion which is the welfare of posterity. This is a desirable Islamic criterion. We have to take care of those who come after us. Now there is more than one way of translating this objective into an actual process of project evaluation. There is no time now to go into details, but please rest assured that there are ways to do it with project evaluation. Whatever project you think will stay more or less intact for the next generation may take extra preference over a project which is to be depreciated fully within the life time of the present generation and so on. There are ways to take care of this in fact.

How can we combine different criteria? This is a technical question, but many people are puzzled by it and refuse to accept more than the capitalist criterion on efficiency for project evaluation. It is like this. In project evaluation criteria, only efficiency is taken care of. The project which has the highest present value gets preference over projects which have less net value measured by market prices. This is the commercial position. Then they try to improve it a little by taking accounting prices. But in a sense, the matter is quite simple. It is efficiency. You measure the output by market prices, actual or accounting, and you write out a single criterion which is net present value. Now, of course convenience for economists is desirable, but Allah did not create the world to make our job *easy*. He had some other purposes in creating the world. It is radical to us, economist, to refuse any sort of challenge that makes our job a little difficult because we prefer only one criterion and having five or six of them is not desirable. The Islamic approach to economic life has more than one objective and we must recognize this fact.

We have more than one objective and we should try to get these various objectives to somehow bear on project evaluation. Now throughout human history, human beings have faced all kinds of situations where more than one criterion had to be taken into account. Now human beings can take all kinds of factors into consideration before making a decision.

Why should we think that we can take more than one criterion into consideration only after we use mathematically economic techniques? We can do it by simple logic although it is more earnest and likely to serve society's interests more than ignoring whatever is not convenient to us. I say this in order

to emphasize that we should not insist that we have to have a mathematically foolproof method of combining criteria. We should do it all the time as best as we can.

However, there are dozens of mathematical techniques that will permit you to combine various objectives into one function. I have in another paper suggested a particular matter where we can struck an Islamic social welfare function for project evaluation by making several hypothetical projects and defining the impact of each project or each of these criteria or any other list of criteria and then assigning a weight to each project. One can show easily that you can, mathematically from the weight assigned to various projects, derive the implicit weights attached to the various criteria. Now this can be done in a particular country or place or planning ministry. They feel they want to formalize the process and have specific numerical ways attached to the various criteria.

Now I must emphasize that whatever ways and means are relevant to the time and place in this country, you may work out a certain system of weights. You have to revise this system because a country's situation, or the world situation changes and you have to have different weights attached to the various project objectives.

So I can only say now that there are available mathematical techniques which permit you to have a very rigorous expression of your various criteria which can be made into some sort of arithmetic procedure to be followed by a large number of people. But we must be careful in using or taking into account various criteria.

I personally have faith in the political economy of project evaluation having worked in the planning ministry in my own country, Syria, for about seven years before going into teaching. I have seen how much attention is paid to project evaluation: wiring many works, making hard decisions on accounting prices, and sending people to Washington to attend seminars project evaluation. It is one of the most popular things in economics. Now this should not make us blind to some very elementary facts. What is the ultimate purpose of project evaluation? It is to avoid bad investments and to select good ones. By a bad investment, we mean an investment which consumes too many resources and gives too little in return. The ultimate purpose of this whole exercise is to arrive at an investment returns which more than the cost of implementing the investment. Now you may go on doing project evaluation as long as you desire, but we should recognize that there is a big hole in the basket. We may keep a

close watch on the openings here and there in the basket of investment and leaving one huge hole in the bottom unattended is not logical.

This hole is the corruption that takes place in public investment which is sometimes corruption in the usual sense and sometimes corruption in a more subtle sense. Suppose I am an expert in meteorology, and I feel attracted to a project to produce something which will provide me with a secure bob or some other benefit. This is also corruption. Now how many projects in a country have been done purely for personal reason. Let alone outright corruption either in the selection process or in the implementation process? We must recognize these facts and not waste too much time in writing project evaluation manuals. We can serve our country equally, and sometimes more effectively by looking at the overall process of project evaluation rather than making further refinements on discounting. As for the rate of discount, you can argue forever about whether it should be 0 percent or 1 percent and about which is more optimal according to the general equilibrium and so on. Now this is a waste of time, and I think that at the stage of development that our countries are in, we should look at the larger picture, and, then project evaluation will have a purpose. But let us not engage ourselves in the game of refining it beyond a certain limit.

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## DISCUSSION

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### **Comment**

Thank you, Mr. Chairman for giving me the floor. I thank Dr. M. A. Zarqa for his presentation of a most important topic in Islamic economics. He has given us a very good insight into it. However, one think which concerns me is that the Islamic criteria for public project evaluation which have been mentioned in this paper may be confused with the objectives and evaluation of project evaluation. I think that the criteria which have been mentioned in the paper may be termed the objectives of project evaluation and the fact is that in conventional economics what criteria we have taken for project evaluation can be use din Islamic economics as well. We can say that making present value criteria or cost benefit criteria on the basis of social marginal benefit and social marginal cost is a most important way to evaluation the project. so the conventional way of project evaluation can be used as criteria for project evaluation in Islamic economics. Therefore, I would like to say that the criteria which have been mentioned may be termed objectives of project evaluation in Islamic economics. Thank you.

### **Dr. Zarqa**

I am very grateful for your comment because perhaps I did not make this point sufficiently clear. Yes, I full agree with the brother and what I want to say is that if you want to conduct Islamic project evaluation then you have to understand it. In my view while introducing objectives in the evaluation project, you have to understand project evaluation. This is a must and this supports Dr. Fahim Khan's comment that we want to introduce Islamic economics within the framework of economics. There is a good deal of literature on how to introduce Islamic ideals. However, if you start with those who do not know what project evaluation is, then these criteria will not help them because they are supplementary to project evaluation, not a replacement of it.

### **Comment**

Thank you brother. I want to ask brother Anas Al Zarqa a question. Suppose that the secular economist is arguing in this way about discounting

cashflow methods and the rate of interest relationship between them. One purpose is to decide which project is the better one. A second purpose is measure the out so as to get the discounting rate which is represented in another internal rate of return. Normally, the secular economist links this to the cost of borrowing, which is interest. They then take a decision as to whether investment will be taken at all or not. Now, we do not want to have anything to do with the borrowing rate because the borrowing rate is zero by administrative order in an interest-free economy.

However, suppose that a secular economist argues that in a flexible market-based system, if the internal rate of return can be calculated and if it is related to the borrowing rate or if it is even related to the *Mudaraba* rate, in the Islamic mode of financing in a free competitive market, the *Mudaraba* rate and the borrowing rate would be equal in time. Then what is *Haram* in linking the discount rate to the interest rate provided that it is also equivalent to the *Mudaraba* rate? I mean can we depend on this type of thing or can we convince a secular economist? If you did not understand me clearly, I mean that in discounting cash flow, we get an- internal rate of return and we use this for project selection purposes to determine which one gives the highest rate of return.

Another purpose is that we can link up with the cost of borrowing which we can say is interest-free. However, in a free market economy system, if interest is prohibited then in the *Mudaraba* mode of financing, the *Mudaraba* rate is a competitive supply and; demand framework would be equal to the government internal rate of return on a competitive basis. The *Mudaraba* rate also can be equal to the rate of borrowing. Therefore, what is the harm in linking the discounting cash flow method rate to the interest rate and justifying the toleration of the interest rate in the economy? I mean you can imagine a secular economist arguing this point.

#### **Dr. Zarqa**

If I understand you correctly, you are saying that whatever rate of return on *Halal* investments prevails in a society, if in that society they are lending and borrowing at interest too the rate of interest will equal the rate of the *Halal* investment. So you can distinguish between the rate of return and the rate of interest from a view. In a perfectly competitive economy, the rate of return on investment will not equal to the rate of interest, but it will usually exceed the rate of interest on fully secured loans. This will be true unless the government is

interfering in the economy, but from a purely competitive economic perspective even in the long run, the rate of return on investment will be higher than the rate of interest on loans. But whatever this may be, it is not our concern as Muslims whether the rate we actually choose for project evaluation is equal to or above or below the interest rate. This is completely insignificant to us. What is more significant to my mind as a Muslim economist is that we do not need to consider the rate of interest because in an Islamic economy, real *Halal* investment will generate rates of return. These are valid indicators that can be used in evaluation. Whether they are equal, above or below is completely immaterial to me. Let it be equal or more or less but as a Muslim if someone can say you cannot have any such interests, so how can you use interest as a criterion when you have nothing to use for project evaluation. But whether they are, I will choose a rate of discounting, equal or above the interest rate in the world or in the same market, which means I would have very little attention to it. It would not bother me.

### **Comment**

You are talking about value-loaded criteria can we find value-free criteria that apply in all subjects?

Dr. Zarqa

This is a very valid comment, but the people who make it do not know some essential facts of economics. For 50 years or more after the turn of the century, economists tried very hard to find in welfare economics any criterion that can be entirely objective and value free so as to be able to compare and prefer one economic situation over another. What was the culmination of these efforts? Samuelson says, that the final word in welfare economics is that it is impossible to arrive at value free criteria for preferring one social situation over another or one economy over another. You must import a set of values from outside the economic system. They call this the social welfare function and if you look at welfare economics, they consider that one important contribution was that of direction where Samuelson showed that if you import criteria, or objectives from outside a social welfare function, you can work out your welfare economics smoothly. However, this had to be imported from outside economic science. There is no way to evaluate it and all economists now recognize this. So when we evaluate a project by the standard and we are already applying to welfare function, it is the Western function which has only one argument, which is that of efficiency. We are not saying we ignore efficiency, but it is not our

only criterion. We have other social goals. We have five or six or whatever number arguments. We have more objectives than efficiency.

In another paper I spelled out how we can have an objective function or *concretize* and measure a suitable social welfare function for project evaluation. There is a systematic way of going about giving it a coefficient. Let us see the way which involves the value judgment of a panel of *Shari'ah* and economics experts who will express their own position on the *Shari'ah* and reality. However, this can be given actual numerical values and it can be implemented and then reestimated when needed. With the change of circumstances in a country, this function can again be reevaluated.

### **Comments by Dr. Salahuddin**

I would like to take up the issue of trying to introduce Islamic criteria and values within the existing system. Is this something mechanical or a transformation? It is not so much a question of Islamic economics, but rather it is the planning methodology which has changed over time. Now over time planners are concerned about the alleviation of poverty, and they are constrained by their tools. They have an aggregative input-output model with which they have planned the whole economy, but they are constrained by technological development. They can not really introduce a multiple-objective so they started to adopt efficiency alone. But the technical framework was not adequate. However, the value that poor people have to be helped in the alleviation of poverty has always been very important. People try to think with the input-output model, but that values judgment was there. They tried to introduce that value into the system, but the system did not accept it. But as the values were introduced, and the technical system was evolving. The technical system started to be transformed and now there is a sort of applied general equilibrium model where you look at the economy in terms of differentials of social class. So I think that it is not merely a question of trying to introduce certain values into the system. the system itself, and I am talking about the technical system, you are talking about this standard, or this value. And they you try to take about this objective one way or another. But with this planning technique, we have tried to import objectives but the objectives could not be implemented precisely because they require technical changes be seriously considered. But later on as they courageously started introducing current technique and the other development, development new computer came to play and important role, then the whole thing started to transform and you have got better assimilation of standards for evaluating the technique.



I have not thought about this clearly. Just knowing the technique and trying to use objectives may lead to more confusion if we not try to transform that technique itself. It is not just merely trying to introduce Islamic values into the system we have to try to transform these techniques. A lot of the tools of conventional economics have to be transformed. Then it lets the value issues be implicit by way of comparison.

However, conventional economics, this is more implicit. I know that behind this there is a value system but no explicit behavior value so when we try to build a system with values that are more explicit, not be merely trying to introduce a system but we should be trying to transform it. We have a long experience in the Islamic economics Research Bureau, here and a lot of constraints. We do not ask for new tools because we have to focus on the tools because in the seminar here, we can talk, and other places where you are talking about the development of methodology so when you talk about standard technique you have to know the standard technique. So you are talking to a layman and say take this to be done, by people to other people. We will have to work on this technique. It is not just another mathematical formula. We have to look at the technique and start developing it. Islamic economics is not just introducing values into the conventional system. It is, I feel, the transformation of conventional economics.

Furthermore, these are Islamic criteria for public project evaluation, but when a private individual is doing project evaluation will he/she take on this social objective. Is private behavior prevailed also by a social objective? I wonder if when a person is trying to decide what action to take, he will also think about whether his neighbor is hungry or not. So private behavior is influenced by social behavior. I wonder whether or not these norms are applicable to private project evaluation. As for the layman, you gave an explanation of the second criterion in which you said that you look at two projects to see which is of the greater benefit to the worker or what ever. However, the second round effect may be that the project which has got less people might be of more benefit to more people. The second round effect or the third round effect may be that more people will benefit in one project which employs less people immediately and another project which employs more people may be of less benefit to less people. This is a complication. The third criterion is that of combating poverty and providing distribution of income and wealth. Now, as you know the Government of Bangladesh is really very concerned with this. In their poverty elimination programs, they voluntarily group people and make target group orientated programs taking into

consideration whether the poverty alleviation program or the one which generates income is better and, subsequently, the poor benefit from the program.

The Prophet (Pbuh) gives a prescription that earning an income is better than giving charity. So now you are talking about combating poverty by establishing a project which is charity-oriented, e.g., setting up an orphanage.

**Dr. Anas Zarqa**

Let me draw your attention to one thing. There is something particular about project evaluation and public finance as two branches of economics which is quite different from the rest of economics. What is it? Economics clearly says that most economic criteria on public finance and on project evaluation are normative in nature, that is, the economics of project evaluation are not saying how the government and businessmen evaluate a project. They feel that they should evaluate projects to arrive at the right decision, the same as public finance.

This leads immediately to the following conclusion. When we want to introduce Islamic economics. These two fields are most convenient for our *effort* to introduce evaluation because they were originally fashioned in a way that is receptive to evaluation since they were normative from the beginning.

Consequently, I do not find as much need as you may feel for developing new techniques, because the techniques developed were normative in nature or they were narrow-minded as far as putting forth one single objective for society which is efficiency. Even those people who proposed efficiency as a single criterion in the beginning are now relaxing their position. *Look* at the World Bank, for instance. They have started saying that they have to pay attention to income distribution. They are proposing the introduction of a single order whenever it can be introduced. Some other values they are introducing are entirely encouraged by Islam, such as, improving income distribution and eradicating poverty.

Consequently, I do not share with you the feeling that we need to develop new techniques. The available techniques can fully accommodate our Islamic dimension. We simply have to put our values in order. The techniques are already created; we do not have to invent them. This may not become another point of view in economics but in this case I think it is proved. So I feel that this is one which is very ripe for a direct sort of Islamic utilization. You

have commented on private versus public evaluation. These are the criteria of public project evaluation. I do not mean that a private Muslim investor ought to disregard these criteria in his own selection. However, I would at the same time say that we cannot impose these criteria on him by the order of a Muslim government which acting in the best interests of its own people and guided by Islamic teaching has decided to curtail the choices available to private investors or to induce them by various ways and means to select projects which are more in the public interest. You have to tell the individual investor that if his presence is *Halal*, you cannot object, but if he wants not only money, but also rewards from Allah, then the more he serves the public interest, the more he serves himself. Of course this depends on the level of the man. He may be keen to do something good in this world in order to benefit in the Hereafter.

I will try to take one or more of these criteria in my own private decision, although they are meant for a public servant. Islam the public servant has to serve the public. He cannot go by his own opinion and inclination and give guidelines for his behavior as a person using his own not public funds. He may select something which is *Halal* although it may be very little. He gets money but not extra money from any source.

Regarding the elimination of poverty, I would agree with your comment that I do not want this to mean handing out money to poor people. This is very superficial. You must make projects and investment and give the poor the power to earn their own living in a productive way. This is necessary wherever possible and it is required. But you must have the transfer arrangement of those who are unable to work for some reason. I thank you for your comments.

### **Question and Comments**

You said that discounting is allowed in Islam, but we know that *Riba is Haram* in Islam. let me put in this say: Discounting is allowed because with discounting there is a payment, because it creates new value. Now when I think that someone gives one hundred taka as a loan and that amount has to be paid hundred and ten a year later, this is *Riba* and *Riba is Haram*. How come discounting is allowed?

### **Dr. Zarqa**

You have raised a question related to why *Riba is* prohibited. It is clearly not allowed in Islam to generate income for the lender. If you lend me

money, there is always the chance that you will not be repaid. The *Shari'ah* does not allow you to take a premium for that risk. It allows you to do it another way. You take whatever personal physical collateral you wish to make the loan less risky, but you cannot make income out of a loan. You can protect your principal by legitimate *Rahn and kafala*, but you cannot make net income out of it. This is as far as the personal loan is concerned. This is entirely different from project evaluation. In a project I am comparing two courses of action. One of them is more productive or more desirable to me on economic grounds and on the grounds of conserving resources. This take into account the time dimension based on the potential productive investment and the project which gives earlier returns. You can take this return and invest in another project and probably earn a little more. so you are giving and you are taking the time dimension into consideration. You are not imposing an increase in a loan on someone. You are comparing various courses of action. So the two things are of a different nature. As I told you, Robinson Crusoe can compare various projects. He is not lending or borrowing from anyone. he is using his own resources in this way or that way. He can still compare rates of return and say he wants to opt for a particular course which gives the higher rate of return. However, borrowing-lending relationship, Allah Ta Ala said, "if you take more this is *Haram*". You have to look for other ways of investment.

Of course, real investment involves risk. This is definitely true. This is a part of life. Real investment always has some risk attached, whereas with a personal loan, as you will know from an economic point of view, the pure rate of interest is something that is above and beyond whatever is required to cover that risk. The lowest rate of interest in economics is the rate of interest on risk-free loans like lending to the government or to a very good corporation. This is the lowest rate of interest. If the rate of interest only covers the chance of non-repayments, this is not the rate of interest. This is a compensation or insurance for nonrepayment. At any rate the *Shari'ah* does not allow this because in fact once you permit an increase to cover the risk of nonpayment, it is very hard to distinguish it from a net increase. The *Shari'ah* puts it another way. You can take whatever collateral to satisfy yourself and to reduce the risk of the loan, but you cannot make a net income out of it. So collateral is Ok, Raihan is Ok, Raihan or Enam, But pure rate of interest is not allowed.

One very instructive thing is when Allah Ta Ala in various *Ayat* states what is *Halal* and *Haramt* and gives the tone of the argument for the human being. For instance, we say, *Muharramat*, He permitted you the good or nice

food and prevented or forbade you the dirty and unclean food. When it comes to *Riba*, look at the *Ayat* at the end of *Suratul Bakar*.

You see the tone of the Qur'an is definite. It is an authoritative tone; it is by authority. He says I permit this; obey this and allow that. So it is in an authoritative tone. Now it is up to us to understand or to explain why Allah Ta Ala chose to forbid *Riba*. However, as far as the tone is concerned, it is very decisive. So while using our money we have to understand the logic behind it, but the rule is absolutely clear.

### **Comments**

I think it will be instructive for us to analyze the present international situation. When we consider the question of *Riba*, it is a fact, as has been presented several times by several of our brothers, that *Riba* is prevalent at the international level and that this is gradually making the poor even poorer. There are quite a few nations in the world today which took substantial loans from different sources and are now unable to repay those loans. It is all because of *Riba*.

They borrowed these funds without reference as to whether the funds are productive or not. Now if we analyze this situation empirically, the question of why *Riba* has been prohibited by Allah Ta Ala becomes very clear, and there can be no compromise on our part on the question of *Riba* at the national, the personal level and the international level. This is particularly true when we consider the case of what is going on at the international level. Thank you.

### **Dr. Zarqa**

I am thankful to Dr. Hossain for raising this point. In fact I fully agree that is one of the underlying reasons for the prohibition of *Riba* at the international level. Of course, we have the rather challenging question which deserves an answer. If international finance took place on a participatory basis which is consistent with the Islamic ways of financing, would the same problem have arisen and if so with the same level and magnitude? I give you the following tentative answer.

If international financing were done to a large extent on the basis of participation where the provider of capital participated in the project where the funds will be used, then this process of participatory financing, I would say, is

like an antibiotic. It kills the germs of corruption and inefficiency. While this is big claim, it is true. I have met with the donors on many occasions. Many of the loans advanced by international banks and by the private sector are given with complete freedom in regard to the ultimate use of the funds. they are satisfied with anything as long as they have the conception that the country has the ability to pay. They do not care, although of course formally they insist that you have to have projects and feasibility studies. But it does not matter to them whether you produce or do not produce with these funds.

What has made them sure that you have the ability to pay and why do they keep loaning while this ability to pay in their concept was initial? If the funds were introduced on a participatory basis no bank in the world would give you any money unless they really studied the project thoroughly. They would make sure that it was sound, they would check the management and whether you can market the product, etc. They know that if they do not do that, they will lose. And they think that they will make money whatever happens to the project. So the possibility of spending money on inefficiency projects would be eliminated if the participatory scheme of financing was followed.

Another point is that it is more difficult for corruption to take place with participatory financing. I will not say that crooks cannot devise ways of also being crooked in participatory financing. They are always very ingenious, but major corruption can be stopped very easily. Why? The provider of funds has absolutely no interest in financing a corrupt project in which the rate of return of the actual money advanced has gone down. Obviously he would prefer a project which is productive and where there is not corruption because this is what will give him a real positive rate of return.

Consequently, if international financing were done on a participatory basis, There would be less inefficiency and corruption. The Kingdom of Morocco took out very large loans to finance the production of phosphate. When the world went into a recession, they could not sell the phosphate. Now if this money had been given on a participatory basis, payments would go down as well, because of the decline in phosphate sales. As a participatory project, the provider of capital would get more out of the country. When they produce more, they could export more. So the repayment would be highly correlated with the balance of payments itself. When the world situation is prosperous and the country is exporting a large amount, the project finance will be higher and more money will be being paid to the foreign financier. When the world situation is declining and there is a recession, then all of these projects will generate less

income and the country will receive less profit thereby paying less to the financier. so you will have a high degree of correlation between the obligation of the country to pay and its actual balance payments.

Under the interest system, the obligations to pay are fixed. So whenever you have a recession, these countries are on the brink of bankruptcy because there is no relation between what they have to pay, which is fixed by interests, and what they are able to produce and export, which is related to the world economic situation. So we definitely can say that if international financing could be done on a participatory basis, corruption would be less, inefficiency would be less and the balance of payments problem would be less as well.

### **Question and Comments**

Thank you Mr. Chairman. You have tried to distinguish between permissible discounting and forbidden discounting. I think that forbidden discounting is in the form of *Riba* which comes to the third party for discounting. The third party offers a lower rate of interest because of financing, and then if an investment is forbidden using discounting because one party is absent from the business, this is only a time factor.

Secondly, when an investment using discounting on the basis of efficiency, it is not forbidden. It is permissible discounting. Am I correct? If not, I would like to have your clarification.

Should we distinguish between permissible discounting and forbidden discounting.? I mean to say that you set down that forbidden discounting is in the form of *Riba*, as in discounting of bills of exchange.

### **Dr. Zarqa**

No, the discounting of a loan is one clear form of *Riba*. In discounting a loan, I have one commercial paper. I have to pay one thousand taka after one year. I check in to a bank and they say, Ok, we will give you nine hundred now, and we will take this paper, and we will wait and collect one thousand from the debtor. This is clearly *Riba*. There can be no question about it.

### **Question**

Is there such a thing as permissible discounting?

**Dr. Zarqa**

Permissible discounting does not involve borrowing or lending at all. it is comparative cash flow over time. n an investment project, you have an expenditure on equipment and you have the return spread over time. So you have two cash flows: one outflow and one inflow. You discount them over time by using' a discounting factor. The question of interest does not arise. It is a comparison of two investment activities. So this is entirely different. Interest rates can only arise with a borrowing-lending relationship. The rate of return which is one form of the discount rate is related to investment. Even a single investing can calculate the rate of return. However, I cannot lend to myself and interest in such a case is illogical. Lending requires two parties: one borrower and one lender. Then there is the rate of interest. So the two are different phenomena. There is no logical relationship between them. One of them is forbidden and the other allowed.

**The Chairman**

I would like to close this session by thanking you all. Thank you, very much for your excellent lecture brother Dr. Zarqa and I would like to thank you for your patient participation. thank you, very much. *Alhamdu li Allah.*



**PART V**

**INTERNATIONAL ECONOMICS  
IN ISLAMIC FRAMEWORK**

***CHAPTER TWENTY-TWO***

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# INTERNATIONAL ECONOMIC RELATIONS AND ORDER IN AN ISLAMIC PERSPECTIVE

*Salahuddin Ahmad\**

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**The Chairman:** *Bismallah Alrahman Alrahim*

I am deeply grateful to the conference authorities for inviting me to conduct this session. There is a very strong tendency for political integration throughout the world. I feel that this tendency should be reviewed only within the political arena. In this session, we are going to discuss the issue of how political integration and economic relations can be developed. Salahuddin, the speaker, is a Bangladeshi economist who graduated from Punjab University and received his Ph.D. from Yale University. He has worked for BIDS, Bangladesh Silpa Bank, (Industrial Bank of Bangladesh) and he is now working as a national expert on the planning commission. I request Salahuddin to present his paper.

**Salahuddin:** *Bismi Allah Al Rahman Al Rahim*

The topic is international economic relations and order - an Islamic perspective. If you look through the literature available, you will find that Islamic economists are mostly involved in discussions on policies which have impact on the internal situation in a country. They talk about monetary policy, but monetary policy mainly affects internal situations. Fiscal policy mainly affects internal situation in a country. However, whatever they talk about it is basically in the sense of a closed economy, although, once in awhile, they do talk about the injustice of international finance. Maududi has talked about it, and so has Siddiqui. Akram Khan is talking about it, but not in a very thorough sense. So, when one is working on international economic relations and order, he is somewhat handicapped. One can make use of his study of the Qur'an, *Sunnah* and whatever *Fuqaha* have said in order to ascertain certain principles with respect to international economic relations and order.

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One of the first books on the subject was Abdul Hamid Abu Sulaiman's. Islamic Theory of International Relations, which derives from Islamic methodology and thought. This book deals with international relations between Non-Muslims and Muslims. He also conducts a detailed discussion of the early jurists' opinions on the relationship between Non-Muslim and Muslim. These jurists talked most of the time of Non-Muslims being hostile and of Muslims are defending themselves. Thus affected the decisions and discussions of jurists about relationships in the Muslim World. Of course, Abdul Hamid Abu Solaiman does not believe in this hostile relationship, deriving his opinion from *Shari'ah* that the relationship, is one between human beings as it has been stated in the Qur'an and the *Sunnah*. These should actually be the driving force in relationships between Muslim countries as well as between Muslims and Non-Muslims. But the issuance of this book is only step to understand this issue, there is a need to talk about the methodology and although he discussed a lot of problems we still need to develop our methodology, since he is not an economist. I recommend this book to anyone who want to learn about the Islamic theory of international relations.

Our topic today is international economic relations and order. I have divided the paper into two parts; the first is an Islamic perspective on how international economic relations should be and what relation and order should we have and the second is how the current situation has deviated from this sort of perspective, together with possible solution. There are several things that the *Shari'ah* has said with respect to the rate of interest, how business should be carried out, how trade should be carried out, etc. I believe that all of these injunctions are applicable in human society as a whole, because Allah's injunction is not for only a single group but for all of mankind.

In fact, there were no national states in ancient times. It was only later that the national states developed. In Surah six, Verse 38, it is stated that Allah's injunctions are not only for a single group, but for all human beings. Therefore, those injunctions which have been applied to internal situations can be applied to international relations as well. Islam views international relations with the following words: "the Earth is a wide expanse that you may go along therein spacious path". This mean that the Earth was created by Allah and you should be able to move about freely on it". Again in Surah 61, "Allah has made Earth subservient to you, so traverse ye through its tracts and enjoy sustenance which He furnishes" (67:15). It is very clear that you do not have to limit yourself to one community. You are free to travel the world. So what about the simple law of internationalism? The communists talk about a much wider

concept of internationalism. Again, the Qur'an talks about transit beyond all the borders of the Earth. So it does not accept any boundary, it goes beyond all bounds between nations to look at the earth as one whole land. Ismail Raji Al Faruqi in his work on divine transcendence (published in a journal in 1971) does not differentiate between human creatures as they all are objects of divine care, or ethical normativeness, or as recipients of God's bounty independent of personal efforts. So, there cannot be any differentiation between one human being as a receiver of God's bounty regardless of faith. This is very important. Islam is not a patriotic religion. Islam is a human religion broadens the mind. God's bounty is for every human being. Ismail Faruqi again in his book 'Tawhid' (published by IIIT USA 1982) derives as his main principle that no individual or group may exploit another individual or group.

In Qur'an it is accepted that groups, tribes, etc., can exist but no groups or individuals may exploit one another. Also no groups may insulate and separate themselves from the rest of mankind with a view to restricting their economic conditions being mercy and *rahmah* to themselves. Therefore, with respect to the common market, it cannot insulate itself according to these principles from the rest of the world. Mankind as a whole has to work together and, of course, it has to recover *Dawah*, and hope, *InshAllah*, that one day the whole world will become Islamic. How will they become Islamic if they cannot come into contact with us, if we separate from the whole world by saying we are Muslims, we are the faithful and they are infidels? We cannot insulate ourselves a part of our *Dawah* activity is an economic and political interrelationship. Therefore, what we see here, is the basic emphasis of Islam on the interrelationship between communities and national states.

My next point is that, Islam believes in the free movement of commodities. First of all this comes to us in the injunction against hoarding and as, it was said here yesterday, Allah has reserved serious punishment for those people who hoard. In Surah 3 Verse 180, and Surah 9 Verse 34 and 35. Islam has extreme injunctions against hoarding. In fact the Prophet (Pbuh) has said that the person who carries commodities from market to market receives *Risq* and the one who holds such committees commits a sin. As far as trade is concerned, there is a great emphasis on the free movement of commodities. In fact from the very beginning, there has been a strong emphasis on trade. When Umer Ibne Al-Khattab (r) established peace and security in the Caliphate, he abolished the old frontiers and customs houses. Ten years before that Rasul Karim (Pbuh) in fact turndown so many of the arrangements, so called arrangements by which each Chieftain derive control.

So from the very beginning, the *laissez faire* or free trade has existed in Islam. So, as soon as peace could be established, all of these boundaries, provincial boundaries, customs houses and other obstacles to trade were completely abolished in one stroke. Prophet Mohammad (Pbuh) said that he abolished all the controls over trade which had been concentrated in one group. At one point of time after Islam came, and during the time of *Sahaba* was the goods of Byzantium, which was the enemy of the Islamic state moved free in and out of the Islamic state. So, regardless of whether the goods are your enemy's or not, they must be allowed to move freely. In the Islamic perspective, free trade goes to that extent. Now from the very beginning, trading has been encouraged. Allama Qurtubi said that the import and export of goods between different places is profitable. So he encouraged trade.

In fact the extensiveness of trade at that time was reflected in the development of the organization of trade. The promissory note, for example, was developed during the time of Hazrat Abdullah ibn Al Zubair before it was even known in Europe. Hazrat Abdullah ibn al Zubair received cash from people going to Iraq and wrote to his brother Mus'ab ibn al Zubair, who was the governor, to pay the travelers. It was in this way that the promissory note system was developed and it also allowed traders in one city to receive the price of their goods in another city. So this system of the transfer of cash or goods was developed during this time and this system was declared *Halal*. Hazrat Ali thinks good of it, Faqi ibn Sirin thinks good of it.

In fact there were famous ancient economists who were praised by the German economist Volker Nienhous. Their works dealt with the Muslim development of trade and especially with what is known as "Transfer" (Connovation in English) or *and 'Hawala'* in Arabic. Supposed that B borrowed money from A. A borrowed money from C. Therefore, it was learned that C can take money from B. If you are familiar with international trade, you will realize how convenient the *Hawala* system was at that time. It is because Islam emphasizes on free trade and the interrelationship between mankind regardless of the state. Trade is developed to such an extent that all instruments were developed. Brother Shiraj talked about the development of checks, similar to modern checks, which date from the time of *Sahaba Kiram*.

When Ibn Khaldun developed his theory of international trade, he talked about how price differences between countries are related to the factor of availability. He was familiar with international trade and with what is called

Hexcher's theory and that sort of thing. The major ideas and innovations that Ibn-Khaldun talked about came from his observation of the material world. It was because such extensive development of trade had taken place within the Arab and Muslim World that Ibn Khaldun could develop his ideas to the level of theories which have not yet been paralleled.

Similarly, the theory of comparative advantage was reported by Nazimuddin. Ibn Khaldun developed the issue of the international division of labor long before Adam Smith developed his theory of domestic division of theory of international labor. The international division of labor is based more on different skills and expertise and less on national endowments. It is not because of availability of material factors of production, whether the labor is more or less available in one country that he fined the international division of labor. Even to differentiate between countries on the basis of skill, one produces steel or textile and another produces carpets. The country which would be producing steel, specialized in steel and the one that has abundance in textile production, is specialized in textile production. So he has gone beyond the comparative advantage and took up the issues of skill and expertise, through which he has developed his theory. The Western World took some time to evolve from Ohlin's theory of comparative advantage to the theory of the skill of expertise. But, centuries ago, Ibn Khaldun developed this theory. So you see Islam's perspective on trade was applied by rethinking. This school was able to take this task which finally extended. They were able to develop such a fine theory which still has no equivalent. When I studied of r my Ph.D. in International trade, we saw the comparative theory as a sort of imperialism. But now that we find Ibn Khaldun's theory predates that theory and therefore we cannot blame it. Perhaps it is a new type of comparative advantage. The use of comparative advantage for this purpose does not invalidate the theory of validity as the Islamization of international trade.

As for international migration and the free movement of labor, we have talked about the free movement of labor and the free movement of commodities. Regarding the free movement of labor, one of my friends from the University of Amsterdam told me that the major problems of the world could be solved if there was a free movement of labor. If so, in many places production problems and inflation problems would cease to exist. Islam has focused on the free movement of labor all over the world. I have mentioned the Qur'anic verses: "Earth is a wide expanse that he may go along therein spacious path" (71:19-20) and "(Allah has) made Earth subservient to you so traverse ye through its tracks and enjoy of the sustenance which he furnishes" (67:15). This specifically

focuses on Hijrah. Sura al Nisa says that "he who leaves his house in the cause of Allah in order that economic conditions may improve finds huge and abundance of wealth in the Earth!" Again in Sura 4 Verse 97 "In what are you engaged they said: we are oppressed in land! the Angles say: Was'nt the land of Gost vast, so you migrate through it..."

We should change our attitude regarding this. Those who have no land and who are oppressed by poverty are not hindered from moving. If you do not find comfort where you are, to go place and abundant wealth. Perhaps during the discussion we can have a greater clarification of the: international relations and the brain drain. At any rate, the above mentioned verses encourage migration in case of economic difficulties, since migration is combined in the two verses it is not only for religious persecution but for economic persecution also. We had a project on the economics of the Qur'an by Zohour in which we discussed the fact that there is not only religious persecution but also economic persecution because, a man purchases his house in the cause of Allah in order that his economic condition improves.

Therefore, the issue of Hijrat or migration is very much encouraged in Islam which believes that Muslims should move from one place to another in search of economic improvement. However, when we look at the world, the free movement of people and commodities does not exist. The Western world has erected barriers. In the early days when the developing world was producing goods, such as, textiles, the West put up barriers. So, the barriers may have been erected against the developing world. The colonials discouraged Muslim producers here and in Baghdad as well. The old craftsmen are no longer there; they have been persecuted. So barriers have been erected.

. In fact, I can say that the developed world is not in favor of the new economic order because it stands against free movement of labor. They benefit from the wealth of the Third World, but they erect barriers against the exports of LDCs. So, as you see, there are deviations from Allah's injunction regarding the free movement of labor. The immigration laws are becoming tougher and tougher. In fact, theoreticians talk about the impact that this will have on developing countries. Keynes, Kindleberger and others have conducted theoretical analyses which demonstrate the efficacy of the free movement of labor even though, they talked about laissez faire and free trade. According to Islam, there should not be any unfair practices in trade. So, there is the *Hisbah* which checks unfair practices and cheating in trade. There should not be any



monopolies, etc. Therefore, in international trade if you start cheating, the people abroad will not buy.

However, there are a lot of discriminatory practices in International trade. In the Guatemala and Tokyo rounds of these GATT negotiations, we all know that there has been discrimination. They lowered trade barriers on industrial goods, but they did not lower trade barriers on agricultural goods which is vital to agricultural production in developing countries. So, you see, they lowered trade barriers on industrial goods, so that developing countries can reciprocate, but they put up barriers on imports from developing countries even though they lowered trade barriers on industrial goods.

At the same time, they imposed voluntary quotas in such a way that it has restricted the sale of simple manufacturing exports from developing countries, such as, textiles, cloth, etc. Developing countries produce simple manufactured goods. Therefore, on the one hand, the trade barriers on industrial goods are lowered but, on the other hand, voluntary quotas have restricted sales to developed countries of simple manufactured goods. They ask for the lowering of trade barriers on industrial goods, so that they can sell computers, machinery but they raise the tariff barriers on agricultural products. So the discrimination goes on continuously.

Let us turn now to the issue of dumping. Dumping means selling goods below cost. Goods are sold below cost in developing countries and as a result the production and the trade of developing countries suffer, and as such there is unequal exchange. GATT is the General Agreement of Trade and Tariff. The word 'tariff' comes from Arabic. This is how we influence trade in the world. For example, Bangladesh produce radios or televisions, but it cannot compete in the international market. Because Japan sells these items below cost. So one can go to USA and ask for having anti-dumping laws. But the cost of litigations is so high in the USA that Government will not save you from dumping before your resources are sucked up. So there is no justice in discriminatory pricing whatever they might say. In recent trade arguments and all these departments of trade or fair trade, there is no fairness for the people of the Third World countries. The basis of Islam is *Adl* and *Ehsan*. This system orders the world order. There is no place where you can have justice although there is an international code of justice, because you cannot get justice. Where can you find justice in the world order? Islam prohibits interest in all dealings including international economic relations. International economic relations are not excluded from this prohibition. Some people attempt to justify this by

convenience, but these things are always temporary. Several billion dollars has gone to European markets, and we all know that this money is earning interest. We are paying international agencies which are creating a lot of trouble for us. The problem is that we are dealing with interest.

In fact I want to draw a digression and draw your attention to the long-term debt, outstanding and disbursed and how it has changed over 20 years. In Somalia it has increased more than nine times as a percentage of the GNP and in Mauritania more than ten times. Egypt is very stable country, but its long-term debt has increased about six times. All of this long-term debt has been mounting the column on interest payments on long-term debt also shows a fantastic rate of growth. So this is how interest has been mounting. As for the debt service ratios as a percentage of exports and services, in some cases it has fallen, but in most cases, it has grown fantastically. In the case of Mali it has increased from 1.4 to 14.2; Niger 4.0 to 32.6; Indonesia, 13.9 to 39.6 and Mauritania 3.4 to 21.6. How can we eliminate interest-based transactions? We will talk about it later, but there are some suggestions. Maududi and Siddiqui talked about the financing of development projects on a profit-loss-sharing basis. This is done by the Islamic Development Bank in equity participation and this can be done in trade financing where we can borrow interest-free funds, even for financing the deficit. Just look at the harm which interest is doing. In international relations there is no justification for depositing money in the Eurocurrency market. It might be temporary, but now we have to find another way.

Islam discourages monopolies, but international monopolies jump tariff barriers in search of cheap factors of production and raw materials, and siphon off large economic surplus. They have been involved in several unethical practices in sovereign policies of the Governments, and they have been responsible for cultural imperialism.

In 1969 foreign-owned direct investment was 1350 billion dollars. But the free World output, excepting communist world was then 20,000 billion dollars. The monopolies are very strong. Of course, not all of them are monopolies, but most of them are. Islam visualized the problem of monopoly. Lenin talked about the growth of capitalism in domestic markets, expanding over the borders and monopolizing the world. So these monopolies have grown across the borders and are playing havoc with the world.

If you want more information you can read the book of Silent Surrender, published in 1970, by Carry Lavet and The American Challenge by J. J Silver Striver. In 1973-74 the united Nations appointed a committee whose name was the Committee of WiseMen to discuss international monopolies. Therefore, what was discouraged in Islam is now being practiced and is playing havoc with international economic relations. Now there is a Qur'anic injunction that says that "wealth should not circulate among a few." There are only a few rich countries and according to proponents of the New International Economic Order (NIEO), this wealth has been acquired by the exploitation of the South by the North especially during the years of colonialism. They exploited gold and took it back to England, and other places. They took spices at below cost and sometimes at no cost. They stopped the growth of industries. As a result, the circulation of wealth becomes in the hands of a few. In fact, Ismail Abdullah in his article "World Chaos or a New Order: At a Third World View" which was published in World Face A New World Order edited by Green and William Rayan from Washington, talks in detail about how these people have exploited. This exploitation is opposition to the verses of Qur'an which say, "For every person whatever gains he or she has earned, and against every person whatever sins he or she has earned."(S 2:286). So, whatever we have belongs to us, and it is not to be taken away from us.

Therefore, wealth is circulated among a few countries and this wealth, according to proponents of the New International Economic Order, has come from the South to which Muslim countries belong. The NIEO demands that tariff and trade barriers be lowered. They also talk about the greater equality of bargaining strength of multinational enterprises and a better flow of foreign aid from developed countries to developing countries. They also talk about collective international action and stabilized commodity prices and stabilizing the long-term demand that have been fluctuating for a long time. The terms of trade for developing countries have been falling. That means we pay more for their products than they pay for our products. Terms of trade have been falling for a long time, but Kindleberger says that there is no good and simple solution to the problem. However, administering the wrong medicine to the patient is worse then giving no medicine at all. We are trying to, for example, raise commodity prices. How do we do it ? Do we interfere in the market? Islam does not believe in interfering in the market. Of course, there is a provision for wage and price control, but not for mass scale stabilizing which depends on buffer stock. Buffer stock, according to Kindleberger, might have a positive impact, but it has a negative impact on the price. A greater dependence on foreign aid is more and more inducive to minimizing foreign aid. What is needed is just to

stand on our own feet. Greater quality of bargaining strength, but who will give you the bargaining strength that your own bargaining strength? We finally agreed to lower trade barrier. What they are proposing in the international economic order we need to look deeper in it. The real cause of our problems lays within the reformation of the prevailing policies. If you look at this, whether the exports of a country or its imports. They are effected by world bank and international situation but there are theories now which said, they are more affected by your balance of payment policy, you inflationary policy. Wrong policies raise the prices of domestic goods and you are not able to export. The wrong balance of payment policy, then you might have been following the policies of interest rate. So we raise the interest rate, the capital flow in the land, but because the uncertainty throughout the world, the speculators are in the market, they are wrongly focused. And because of the wrong focus, they aggravate the price fluctuation.

One of the beneficial aspect of speculation whatever, we call it, is that you expect the price will rise tomorrow. Because of adverse condition in the wheat market, for example, so what you can do, if you buy more wheat now, the price of today will rise and tomorrow you supply it so the price will be falling. But if you go wrong, a lot of instability will arise. So that has happened in this system, because of a lot of greed and speculations, etc. We find that because of the interest-based. policies, which our economy is following, our own international trade is badly affected. So, we are not able to export more, and we are under obligation to import more and more. Of course, as Muhammad Umer Chapra was talking about whether you import more and more depends on your consumption pattern and consumption/absorption capacity. We have followed within our country, the pattern of Western consumer society, while Islamic injunctions call to moderate our consumption. If you like to reduce absorption of your .country by having moderation of expenditure, if fiscal discipline were there, Government not expending money on extravagant items. This absorption will go down. Your imports will go down. Therefore, aid dependence will go down. At present, you can not choose from where you borrow because you are much dependent on foreign borrowing and paid. There is much conspicuous consumption.

If internal policies follow the Islamic injunctions, aid dependence might be reduced. The bargaining strength of multinationals would be reduced and so would trade barriers. Then we would be able to dictate our own terms. They are waiting to deal with us and to give us money for our export, or to encourage our import from them. They need us to borrow money from them so that they can

earn interest and increase their exports. Then we can dictate the terms of free trade. All, of this can be achieved if we follow the Islamic injunctions of founding a society based on *Adl* and *Ihsan*. We know that through *Zakah*, there is a continuous income distribution. This is accepted by Islamic economists. *Zakah* is continuously flowing to the poor and poor are coming up to *Nisab*. It is a dynamic economy. If all Muslim countries follow Islamic injunctions, the world will also follow. We believe in Allah's law and if we show our example through practice and actual behavior then they will embrace Islam, *InshAllah*. So, if we start following this, perhaps it will be the basis of an international order based on *Adl* and *Ihsan*.

Siddiqui said that just merely giving away interest-free borrowing from abroad was not enough and that we need a complete system based on *Adl* and *Ihsan*. But, I do not believe in the need for a complicated system. It is better if we all establish Islam socially in our own countries. All injustices will disappear, if we can establish an Islamic economy in our own countries and join together in the *Ummah* in cooperation.

This cooperation is important, because Islam believes that economy is based on cooperation. Of course, competition is not neglected but the main focus is on cooperation. It is said in the Qur'an Sura Ambia, Verse 92: "Your *Ummah* is one single *Ummah*, and I am your Lord, therefore cherish and serve Me (and no other)." Then in the *Hadith*, the Prophet (Pbuh) said "Muslims in friendly relations mutual compassion and sympathy are similar to a single body, if one of its parts complains from an illness, then the whole body suffers from sleepiness and fever". There are other verses and sayings as well.

There is some progress in the OIC. They are playing a leading role. There is the famous Makkah declaration. The Islamic *Ummah* are close to each other on the basis of this declaration. We feel that we should group together. All over the world, you find economic groupings such as SAARC and ASIAN. Those who are trained in modern economics in Western universities have been taught that economic groupings are good. Now we find it easier because our *Iman* and awareness have increased. Not all economic suggestions are always based on *Iman* as well as on exigency. However, it is an excellent idea to come together based on one faith. The European economic group is not based on faith. In Table Two we find the OIC member countries share in intercommunal trade in exports. The figures are very small, but they have grown over time. In some cases like Yemen, they are falling. But in most cases, they have grown. Imports have also grown.

Muslim countries should try to increase their economic integration. Already the IDB has been established and it is providing interest-free finance in trade and industry. It provides equity financing for development projects and joint ventures.

The financial institutions of the Islamic world could get together with authorized capital of 25 billion dollars, which is one-third of the World Bank's authorized capital. The Saudi Fund for Development established in 1975 has authorized capital of 7.3 billion dollars. The Kuwait Fund for Economic Development established in 1972 has authorized capital of 7 billion dollars. The OPEC Fund for International Development established in 1976 has authorized capital of 4 billion dollars. The Arab Fund for socioeconomic Development established in 1974 has authorized capital of 2.8 billion dollars. The Abu Dhabi Fund for Arab Development established in 1974 has authorized capital of 1.1 billion dollars. The Iraqi Fund for External Development established in 1974 has authorized capital of 1.1 billion dollars. The Arab Bank Economic Development for Africa established in 1976 has authorized capital of 0.7 billion dollars. Added together these is nearly 25 billion dollars compared to the World Bank's 75 billion dollars. If the IDB and all of these funds get together, then they would be approximately one-third of the World Bank.

Now, if we join with other Southern banks such as, the Asian Development Bank and the Inter American Bank, we will be able to convince the donors that we are a power to be reckoned with. We can then talk with them about such issues as the low flow of assets or wealth, the low flow of debts and high debt servicing. I have proposed the development of an integrated capital market for the South. There should be no interest-based financial techniques. We should replace all of these interest-bearing instruments with the profit-loss sharing system which involves joint ventures, equity participation profits, the operation of ordinary development institutions, cofinancing and many more multinational development institutions of the South. Another thing is the need for pressure to be exerted by Arab subscribers to the IMF for higher concessionary aid and grants to the South. Arabs have become very high subscribers of the IMF, but they have not really played a significant role.

If we have more concessionary aid and grants, we can then diversify the external trade structure by diversifying industries. We will then be able to have more cooperation in the Islamic World. Then we can increase capital from oil surplus Muslim countries to other Muslim countries which is one of the objectives of the OIC. I am not saying that all funds have to be circulated. This

is one of the objectives of the OIC. If this could be increased, our dependence on the outside would be reduced. I am saying that this is a temporary measure in moving towards an Islamic system free of interest where *Zakah* is paid, a system based on *Adl* and *Ihsan* in which all the injunctions of life are obeyed. This is a method which would give some insulin in our economy for some time, in place of interest-based international capitalism. We insulate ourselves temporarily, may be greater flow of international aid coming temporarily at the same time we change our policies, these policies will cause increase in concessionaire aid i.e. an increase in capital movement.

The only way to do this is for the people to involve themselves in principles of cooperation inspired from Islamic faith because we have nothing else to do and we cannot involve the Islamic injunctions unless we do something ourselves. So that there is no alternative. If a person deposits money in an interest free bank, he cannot do so unless he tried to set-up a interest free bank his country. If I am putting money in the Eurocurrency market, and it do something else, then I don't believe in the required changes then I have no right to put money in Eurocurrency market. For convenience I must do this lesser of the bad, lesser of the harm. Those things cannot be done unless we participate in Jihad against the rate of interest and all the unIslamic practices. All of these are not the ultimate solutions; they are temporary solutions but, with the objective of establishing a new international economic order based on *Adl-wa-Ihsan*. Where there is no interest and no unIslamic practices. Thank you.

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## DISCUSSION

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### Brother Siraj's Comment

I would first of all like to relate international trade to the power and strength any nation has. We must deal with international trade and the power and the ability to control it. In the nineteenth century, Egypt imposed certain tariffs on imports. Egypt was only able to impose tariffs after 1936 and that of course, was after the taking of the factories and enterprises in Egypt. So I do not agree with our brother Salahuddin about lowering the boundaries and barriers of trade between Muslim brothers. We should differentiate in fact between two things. We cannot impose any limitations on international trade. We must invest new concepts regarding trade between Muslim countries. We must think of it as internal trade rather than international trade. Well let me express my feelings this way. If we can concentrate on the concepts that this is the internal trade between the Muslim countries instead of just the you may say. I do not like to see us wasting our time and things to theorize the trade for other nations.

### Salahuddin Ahmed

I think this is a very important point. It was not because you tried to raise tariffs that there was a war against you. You were trying to industrialize your economy at that time and you built many factories. Mohammed Ali Pasha was a very nationalistic person. He was very modern, and he developed factories. The English were worried that you would become strong, not by trying to impose tariffs but because your industrial power could be used against them. It was for that reason that they completely demolished your factories.

I said that Islam believes in the free movement of commodities which is proven by history. Nothing is said about the raising of trade barriers and there are no principles in the *Shari'ah* advocating the raising of trade barriers except for increased revenue, which is a different issue. However, there are certain principles which of course overtake other principles in the case of public interest. At this moment, the public interest is that if I do not protect my industries I shall die. So that issues of free movement of commodities on international level are not our priority, but then I may impose barriers temporarily as a preparation and a start of internal grouping within the Islamic



world. May be, we have trade flow amongst Egypt and all OIC countries. But as preparation for a time. *InshAllah* the world will become a place where there are no trade barriers. Because we will have a power to recover. But at this moment, I am not suggesting it. If there was a misunderstanding. I am sorry. I am not suggesting that trade barriers should be removed. Islam believes in the principle of the free movement of commodities and not only between Islamic countries. From Byzantium commodities moved freely into Islamic states. Islamic states imposed few tariff although they had the power to do so, and the tariffs were only for revenue. Now, we impose barriers, so they cannot demolish us. But in principle, we need to establish economic order. There should not be barriers in the long run. *InshAllah*, we believe that a new international economic order based on Islamic principles will be established. Then we will become a power to be reckoned with. Millions of people will one day accept me. I also believe in not putting trade barriers. Because, these people are not going to buy my goods. Why should England put up barriers? Because we are powerful? As long as we are not powerful, they do not put up barriers. Even within the Islamic world, is not correct to put up trade barriers against Indonesia. We can not go and say to the governments remove trade barriers even after you establish one sort of custom unions. It has to go slowly and gradually.

#### **Mondal's Comments**

I thank Salahuddin for presenting a good paper, but I think in some cases that he has gets Utopian ideas. Of course, at this present moment, non-Muslims in other countries do not have the same objectives that we do. If they did, it would be better. However, you say that the Islamic point of view is based on *Adl-wa-Ihsan*. If we could do that then definitely it would be better. However, I think of course you also agree that at present it is not possible for us. We have to wait for sometime, may be for decades or perhaps for centuries. If we could form a common market perhaps we would do a beginning for the moment, for some years or for some decades. Then we think in terms of free movement, of course, for Islamic free movement.

#### **Salahuddin**

Most of the thoughts of Islamic economics are Utopian, because we believe in interest-free, etc. But how can we have interest free? When we were under the colonialists, we could only dream. However, in the last twenty or thirty years, we have started one or two institutions, such as interest-free

banking. We have started Jihad, and, perhaps, through Jihad, we will be able to succeed.

### **Shah Mohammad Habibur Rahman's Comments**

I would like to request the organizers, sponsors and cosponsors, to make available to all of us as soon as the seminar is over a full transcription of the paper that have been presented. Perhaps, the Islamic Foundation or the IRTI, can provide us with these papers because until we get them part of the seminar has not been fulfilled. Salahuddin wants to accelerate the process of economic interactions among Muslim countries. Here, I would like to raise two issues: first, the Government of Bangladesh has sincerely invited cooperation from Muslim countries. However, bureaucratic pressure and laws, and prevailing in Bangladesh are not congenial for that sort of cooperation. As far as I know, two groups of people in Saudi Arabia and Kuwait have proposed the establishment of some industries. After six amended efforts, they have not been able to get permission and have given up. Secondly, countries in the Arab World, have been fighting among themselves. There was the Iraq-Iran war, the Iraq-Kuwait war, and other border clashes. This probably cost billion of dollars. I think that war must be stopped. Let us build up our nations and the *Ummah's* cooperation by stopping unnecessary wars. Thank you, very much.

### **Salahuddin Ahmed**

I have been informed by brother Monzer Kahf, that this seminar is not a standard paper presentation seminar. However, these papers are being recorded and these tapes will be transcribed. Once they are transcribed, the people who presented the papers will be given a chance to rewrite their papers or lectures in the form of a paper which will be published later. In most of the discussions, a lot of new ideas are coming up. People who are contributing new papers will

develop their papers. After that these papers will be published in a book. I would like to suggest to the Islamic Foundation that before it is published, the participants should be given cyclostyle copies from the Islamic Foundation or the Islamic Development Bank.

As for the impediments to cooperation, I have just discussed with brother Siraj the fact that it is difficult even among Muslim countries. So, Indonesia may not dismantle tariffs against Saudi Arabia. Therefore, we have to account for all of these impediments, in order to become more practical. We have to recognize and identify the impediments and as the movement of

Islamization of different economies progresses, a lot of the barriers in the minds of bureaucrats will also come down. There are many committed Muslims sitting in bureaucracies who will not do things right now. Their response depends on how they will be talked to, and how they will be asked to react to these new ideas. The idea of an Islamic common market is new to them, so they will not extend their hands. However, if they see other countries doing it, they may be interested to do it as well.

#### **Hamid**

Regarding aid obviously poor countries receive aid not only from non Muslim countries but also from Muslim countries. You said that we should convince donors to introduce a profit-sharing financing system. I would like to know whether there has been any attempt to do this, at least in terms of aid to Muslim countries. If we can prove that profit sharing is more profitable not only for the donors but also for the recipients, then we can obviously set an example for non-Muslim countries to follow.

#### **Abu Ahmad**

As we have seen, the West is responsible for many of the evils of today. They have exploited us and, all that they have exploited belongs to the North, not to the South. They are Pitting us against each other; they are killing and bombing us and then we say that there should not be any trade barriers, as one brother said earlier. There should be different trade policies: one for Muslim countries and another for the West or North. Otherwise, if you establish an international system based on *Adl*, the West will just exploit us in a marginable way though there should be some sorts of *Adl* based arrangement. Another point is that they are threatening us and they are compelling us to sell our commodities at the price that they want to give us. Take, for example, Arab oil, who benefits from the sale of Arab oil? They fix the price and they tell us what amount is to be produced. Let this be the Muslim World's strong defence. No matter what policy based of Islamic principles you establish, you will not be able to face those evils which come from the North. And when you call the ADB a Third World organization, I beg to differ with you. It belongs to the North, not to the South. It is being financed by the North. Our participation is very small. They are giving as the World Bank tells them to. Another point is that no justice can be hoped far from the North by means of persuasion alone. Similarly, we cannot compel them to be just. We are suffering because of the

trade barriers against Third World countries. How much do we receive as aid? We have not received anything because of their exploitation.

There is equity financing by the Islamic Development Bank here in Bangladesh. Unfortunately, if there is any representative from the Islamic Development Bank, he should speak out. We do not receive a fair share from that equity participation. There are a few companies, but I do not know what type of management those companies have. If the IDB wants to give a direction to the bureaucracy of Bangladesh, then they are mistaken. They are not receiving any benefit from the capital here. However, other multinational companies based in England, Washington and Japan are getting their fair share. Why is the IDB not getting any share from Bangladesh? These things should be thought about.

### **Salahuddin Ahmad**

I have not put forth any theory of trade barriers, I have said what Islam believes. Islam believes in the free movement of trade. This is dependent on many things each country has its own history of development and colonialism and its own development policies and their relationship with the world. The objective is to reduce trade barriers. I would say that the larger objective is to set up an Islamic world order, and an Islamic common market is a tool to achieving that. We will not accept any theory of Adam Smith. We will not accept any theory from Western economists. We go back to the theory of free trade in Islam. The basis is different, i.e., to remove exploitation. The free movement of commodities will remove the exploitation of a free society. Society will be free when we remove all exploitation, such as interest.

### **K. T. Hossain**

What can Muslim countries do themselves? Salahuddin enlightened us in his paper with some quotations from the Qur'an and *Hadith*. And these quotations are very clear. He also mentioned immigration laws. Now, immigration laws in developed countries are becoming tougher and tougher. But how about promoting immigration among the Muslim countries? Now if the Qur'an appears to direct that according to the quotations he cited, then how about some positive movements in the promotion of development everywhere within the Muslim *Ummah*? It seems that immigration deserves more attention that it is getting now. Data shows that it has increased over time. It reduces remittances. Whether there should be more intra-Islamic trade is not dependent

on the activities of the countries. Let us start working in *Dawah* activities, so that our minds will change. We all are in a sleep. It is an ingredient of our culture inherited from our colonial past. I think this practice is detrimental to the development of industry in countries like ours. How can this problem be tackled in the Islamic perspective in order to lead the country to industrial development?

### **Salahuddin**

As far as the infant industry argument is concerned, I go to Islamic perspective later on. When does industry can grow up ? That is the issue which is gripping the minds of the economists. Let me call for free movement of commodity whether it will be harmful to infant industry argument.

### **Chairman's Comments**

I feel that this should be discussed individually. Let us drop it for the moment.

### **Mondal's Question**

Since Muslim countries are dispersed geographically and are in different stages of economic development, it may be more useful to talk about optimum trade areas within the Islamic *Ummah*. What is your view on this?

Similarly, the currencies of different Muslim countries have widely different percentages of acceptability as a means of international payment. It may be useful to talk about optimal currency areas. Would you give your views on this?

### **Salahuddin**

I think that the optimal trade area may be a good idea to start with and then we can link the trade areas. However, the issue is: How can we define optimum? I define an optimum trade area as countries with a geographical continuity, size does not really matter. So I think geographical contiguity can be taken as the criterion for the optimal trade area. As far as an optimal currency area is concerned, I do not know, if there really are different percentages of acceptability. The dollar has been the international currency for a long time. Can the Islamic dinar have the same acceptability? Monetary cooperation is

different from trade cooperation. For trade cooperation and factor movement, geographical continuity may be the important thing. But in monetary cooperation, geographical continuity may not be important. You talked about acceptability but the dollar has for a long time been the standard currency. We could accept the Islamic dinar but I do not know whether the optimal currency area is a good idea. Perhaps you could elaborate.

### **Mondal**

It is not necessary that optimal currency areas be contiguous. They may be geographically dispersed. Optimal trade areas consist of those countries having more or less the same economic characteristics, similar to each other, for example, in terms of production function and structure of the economy. So geographical contiguity is not the only criterion. We should have other criteria e.g. structural change in the economy, the level of industrialization and the production function. Some countries may have rigid production structures, while other countries may have production structures which respond to the price mechanism. So putting different countries together may not be a very useful idea with respect to trade liberalization and economic development.

### **Salahuddin**

As far as the other conditions are concerned, they can be manipulated. If two countries 'can trade, then their trade structures are not compatible, then policies can be undertaken different Islamic countries. Geographical contiguity is a parameter which cannot be changed. But other parameters can be changed. In a system which we are attempting to optimize, putting forth several constraints makes it difficult to find solutions. however, with a small number of constraints, you have a chance to achieve an optimum situation which is likely to be sustained. In the Islamic world, the geographic groups are Arabs, South Asians, West African and the Magrib group. If you have these groups with geographic contiguity, you can start changing other variables and policies.

### **Mondal**

Bangladesh, for example, does not have geographical contiguity with any other Muslim country. Then what can Bangladesh do?

## **Salahuddin**

In a relative sense, it is contiguous; in an absolute sense, it is not contiguous.

## **Mohammed Zafar**

The learned speaker has referred to some *Ayahs* of the Holy Qur'an, and he also stated several times that Islam favors the free movement of goods. This is the ideal condition stated by Islam. I think this economic ideal condition is linked with the political ideal condition as well. The ideal political condition is, when there is one Islamic state and the ideal condition can be established with an ideal free movement of goods. However, considering the facts, there are many Islamic countries which have, political boundaries or political barriers. Is it feasible or practicable that all Islamic states could exist without trade barriers, tariffs or any kind of customs system? Therefore, it is the duty of Islamic economists, *Fukaha* and *Muslihin* to foster closer economic relations, keeping some kind of trade barriers and tariffs for protecting their national interests, because, we do not have an ideal condition of one Islamic state. I can cite one example: the Holy Qur'an says, "*Inna al Salata tanha wanal fahsha' wa al munkar*". It does not mean to have any police force to maintain law and order. It is the duty of the *Muslihin*, *Fuqaha* and economists to interpret the principles of the Holy Qur'an and *Sunnah* in the light of the practical positions of society.

## **Salahuddin Ahmad**

I said we do not accept the theory of the West with respect to free trade where free trade means the dismantling of trade barriers. We said the free movement of trade will exist if Islamic injunctions are obeyed. And we said low mode view of common market. How we need economic integration in the Muslim countries. Not an objective of dismantling of trade barrier. I see an Islamic common market as a part of Jihad to establish the Islamic system. I repeat, and please quote me on this, that with the Islamic common market, economic integration will be an attempt to establish the Islamic system. We will start following the dictates of the World Bank and the IMF. Why do I say that? Precisely because of the political system. I say unless we get together and work as one body, we will not be able to fight for the establishment of the Islamic system in this world. Our objective should be to start reducing the percentage of activities based on convenience. We can do that, but we cannot do it unless we work together. So I am referring to this political strength; I am not looking

at politicizing the *Ummah*. If you want my personal view, I want to Islamize the entire world, not the *Ummah*; I am not setting-up an *Ummah* of a billion people. My objective is to set up an Islamic order all over the world. So, therefore, I encourage *Dawah* activities. Some people view that as an objective, but it is not an objective. It is not a question *of* reducing trade barriers. Bangladesh will maintain its trade barriers even in a common market, if necessary, for other objectives. The *Fukaha* will decide if we need trade barriers. We do not have an interest-free system in Bangladesh. But ultimately we want to be together in an optimal trade area and in an optimal currency area. We have small groups but we all want to be united again. Perhaps not only because *of* trade but to act as one body to fight against the system that subjugated us for centuries. So setting up an Islamic *Ummah* or common market is a method we will use to establish an Islamic system all over the world. May Allah help us to do this.

### **Question to Sahahuddin**

How can we build one Muslim state and Islamize the whole international spectrum?

### **Salahuddin**

The way to do this is for all Muslims to start being good Muslims in everything they do in order to convince non-Muslims that Islam is a good religion. Islamization starts with good Muslim and start with attempting to change the world and through our efforts to build stone by stone gradually. But I do not believe that we are alone in this fight. Why are we sitting here? We are involved in Jihad in this room, we are a part *of* the Jihad which is going on all over the world. We should be prepared for that. *InshAllah*, we will be able to build the system.

The balance *of* payments of poor Muslim countries and institutions like the IMF should be established as soon as possible.

An Islamic clearing union should be established which promotes trade and commerce among Muslim countries. As regards the trade and commerce *of* Muslim countries, poor Muslim countries should be treated as most favored nations. The above points should be included in your article as possible solutions.



I think as far as International Monetary Fund or Islamic Monetary Fund is concerned, it might be a good idea.

## CHAPTER TWENTY- THREE

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## THE INTERNATIONAL DEBT PROBLEM

*M. Umar Chapra*<sup>\*</sup>

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### Chairman

I invite Chapra to give his lecture.

### Chapra

I am particularly indebted to the Islamic Research and Training Institute of the IDB, to Islamic Foundation of the Ministry of Religious Affairs of Bangladesh and the al Baraka Bank who have organized this seminar in this city. This shows the concern that exists for solving the economic problems of mankind. We all know very well that socialism has failed but many people seem to claim now that may be capitalism is the supreme. But it is not, because it is facing a lot of problems and we do not know when another crash may come in the Stock Market, as it happened a few years ago and, the economy this time may be weakened which did not happen somehow last time. There are a number of crises being faced by the world economy in the financial market, in the stock market, in the commodity market, etc. The United States banks and banks of many other countries are going through crises and we don't know when one of the big banks may fail and lead to a serious crisis in the financial market. But any way, we are not going to talk about this problem here, my main subject is only one and that is the debt problem that now exists, international debt problem. Why there is a debt problem and how Islam can help solve this debt problem ?

You all know very well, in the early 1980's there was a serious crisis in the international debt market. The debt had driven to a very high level and many of the countries were facing difficulties in servicing their debts. Somehow the world community got together and provided relief and now the problem has

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subsided a little bit since 1987, but it is still serious particularly because of the series of the recessions in the United States. The problem has again got strength and questions are being raised, what is the right solution for it ?

I will only talk about three issues at the moment, one: the magnitude of the debt problem, second, the root causes of this, and third, the solution. The solution, first of all, in the light of neo-classical economy, which is being pursued by the IMF and the world bank and the solution is Islamic economic perspectives. In 1989, the total debt of low and middle income developing countries was around US \$ 1,200 billions. In 1980, it was less than US \$ 600 billion. That means, in less than a decade, the debt has doubled. The rate of growth in the debt was more than 8%. This 8% cannot give a clear idea until it is compared with something else, and the best thing to compare this rate with is the growth in gross national product and the export of goods and services. The growth in GNP goes only at 3.4%. When you compare 8%, the growth in debt against 3.4%, the growth in GNP you will feel the difference. The growth in export of goods and services was only 4.3% which means the growth in debt was twice as high as that in export of goods and services.

What about the Muslim countries, before I started collecting the data for this sort of comparison, I thought the Muslim countries might be in a better position, but I was thoroughly disappointed when I reached certain figure by adding up the debt of low and middle income Muslim countries. The debt of Muslim countries was about \$ 341 billion in 1989 and the rate of growth in debt since 1980 has been 9.8%, which is higher than the rate of growth of debt of all low and middle income developing countries. The more revealing fact is that the GNP of Muslim countries is only 25% of the total GNP of low and middle income developing countries but their debt is not 25%, it is, in fact more than 30%. The GNP of these countries is only 25% of the total GNP of low and middle income countries and their debt is above 30%. So, you can feel that Muslim countries are in somewhat more serious condition than all developing countries put together.

Of course, you can take groups of developing countries like Latin American countries which may be worse off, but if you take an overall position, we are not better. Out of the 45 members of the Islamic Development Bank, 14 member countries are severely indebted and 11 are moderately indebted, which means about 25 out of 45 member countries are in a bad situation as far as the debt is concerned. Another bad position, or a position which is serious, is that the net transfer is negative, yet any country can be in a slightly better position.

In other words if you get a loan of 100 and you have to pay out a debt service 80, you at least get 20. May be you can support some of your expenditure by the 20 extra Riyals. But the overall position for all developing countries is that net transfers are negative, for all low and middle income countries, net transfer in 1980 were minus 40 billion. In other words, they receive less than what they have to pay out and the difference was 40 billion. Muslim countries also have to pay out 6.4 billion more than what they have received in terms of debt. The net transfer makes the position more serious because the country then have to create a larger export service not only to be able to import their needed goods and services but also to take account of the negative net transfers.

But what is the root-cause of this problem ? Of course you all will agree, you will say: too much spending. You all know that. In all our societies when does a person get into a debt problem ? It is when expenses are too much compared with one's income and one has to borrow, and then comes the time that nobody is willing to lend to him. This is what is now really happening with developing countries. The creditors are reluctant to lend, and may be that is one of the reasons that the net transfers are negative. So much spending and this is what technically called excessive absorption. Excessive absorption in terms of what: consumption and investment. What the private and public sectors are consuming and investing is more than what their gross national product justifies. If this excessive absorption had been due primarily to investment, we could have condoned it, we can say that in future the position will become better, as a result of this investment, because there is a time span between investment and growth in gross national product and ultimately the growth of GNP will be higher and they will be able to service the debt.

But this is not the case. For the rise in debt, one of the major reasons has been an increase in consumption. Consumption has grown at a higher rate than investment and we have borrowed for both purposes, the result is this difficulty in servicing the debt. So, there are two gaps: a saving and investment gap and there is an import and export gap. The implications of the savings and investment gap are very bad for any society, that the society is not able to save enough to be able to invest. This is going to affect its future. First of all, somehow the difference has to be taken care of and how do you meet the difference. What we have done, developing countries or Muslim countries is that we have met part of this difference by monetary expansion, higher monetary expansion. This has lead to higher rate of inflation and you can see the rate of inflation in some Muslim countries. On an average it is much higher than the rate of inflation in industrial countries. This raises interest rate, so investment

becomes difficult. People are afraid all the time of borrowing at the higher rate of interest because they feel their revenues, their cash flow, may not be sufficient to enable them to service the debt and investment tends to go down. This leads to lower rate of economic growth, higher unemployment, lower level of exports, lower competitiveness and ultimately it is a serious problem for any economy.

The implications of the export/import gap are also similarly very serious, because when our exports are unable to meet our imports' needs, we borrow. So, there is more external borrowing and this means higher debt servicing in the future. This means the already existing state of lack of surplus needed for investments will even be worse. This will mean lower rate of growth, greater unemployment and greater economic difficulties. So, we can all see that the major cause of this problem is too much spending compared with our income or in the technical jargon excess absorption. Now, what is the solution for this problem. Of course, there is one solution which we all welcome but I will not give much time to it. There is another solution which is hard but I will devote more time for it. The easiest solution for this problem is of course as the *Qur'an* says if somebody is in difficulty, extend the time on repayment. But if you forgive this is better for you if you know.

Now, this has acquired a fancy technical name, it is rescheduling of debts; we all find it all the time in the press and IMF publication and we think it is something new. But the *Qur'an* talked about it 1400 years ago [*Nazirah*]. There is also *Ifa'* which is talked about in the present dialogue, i.e. debt forgiving. But debt forgiving is a politically oriented action. In other words, if Bangladesh needs debt forgiving, nobody will give it. Because, it does not occupy a significantly important position in the international political framework. But if Poland wants this forgiving, it will be given because the Western countries have to serve some vested interests and they feel that Polish economy if it is improved by means of debt forgiving, it may help them. Debt forgiving has been in a way politically oriented and most of the Muslim countries, I believe, will not have much access to it. It is difficult for them to have access even to debt rescheduling, they have to beg the lender for some kind of debt rescheduling. So, the real conclusion for all countries lies in socioeconomic re-structuring, because if you give debt forgiving and debt rescheduling all the time, the problem can arise again and again and again.

The permanent solution to this problem is socioeconomic re-structuring. So that the problem does not arise. Like if you were to give a loan to a friend

of yours and you know his expenses. You will give money and he will buy with that money chocolate and consume it or he will go to resort and play gambling and loose the money. If you keep on forgiving the debt, it is not good for him. Also, somebody who does not work hard enough to reduce his wasteful style of life and you keep on forgiving his debt, you yourself also will get into trouble. The best thing is to help him temporarily. Yes, forgive him his debt, rescheduling, in order to induce him to resort to socioeconomic re-structuring, so that the problem is solved.

In other words, the excessive spending or excessive absorption declines and the problems come to an end. But let me talk of reducing excessive absorption. We have to do it in a manner that does not conflict with the goals of society. It is very easy to reduce the consumption in a way that affects the poor people, more than it affects the rich people. Or you reduce the rate of growth of the economy, and hurt future generations. It can be done. You want to have a re-structuring which is not unjust to the poor, which will not be bad for growth in the future, as injustice and lower rate of growth will not be workable for a long period of time.

We come, now, to two different types of re-structuring: one of them is being actively pursued but the other one is being actively considered but not pursued. The one that has been actively pursued is neo-classical re-structuring, which is being forced upon developing, or indebted developing countries by the IMF and the World Bank. So, you would say that neo-classical re-structuring has an IMF and World Bank stamp on it. We all know that this neo-classical economy which is the source of the ideas of this re-structuring, is secularist. It is not concerned with the distribution issue and it does not pass values test. I don't want to go through the details of it, but it is said by the IMF and World Bank both, in their publications, that distributional issues are not an international concern. They are not worried about them. They want the countries to adopt a certain kind of re-structuring. But even if the distributional issue are not an international consideration, how can the country sets them aside, politically, this may not be feasible even if there is an economic feasibility.

## **THE CONTENTS OF NEO-CLASSICAL RE-STRUCTURING**

### **1. Reducing Spending**

First of all, they want all governments to reduce their spending. But where to reduce spending ? This is not the IMF concern. You reduce spending anywhere. As long as you reduce spending, you will get full mark. But we can reduce spending in several different ways. You can reduce unnecessary spending, this can be one alternative. You can reduce spending on defence, another alternative. You can reduce spending on welfare services like education, subsidies to the poor, health program, rural development program and so on. You can reduce spending on these. Of course, IMF is not concerned about it.

What happens is that under IMF pressure the governments resort to reduction which is most inadvisable. They reduce their welfare program. Irrespective of where you go, whether it is Sweden, USA, UK or Germany, or in low and middle income countries, whenever the government talks of reducing spending, generally the first target is welfare spending and not unnecessary spending. Because, unnecessary spending benefit vested interests and the governments do not wish to displease them. Who in Pakistan could talk about reducing defense spending. Even now, when the IMF is pressuring this program very forcefully on Pakistan, hammering the heads of Pakistani officials in the State Bank. But recent budget talks of raising defence spending by 13%, a requisite, defence spending. You can reduce the spending elsewhere, such as the expenditure on those people who are making the least noise, the poor people who are unorganized, they do not constitute a pressure group, that could serve their vested interests. This is what happens, so one of the best reasons is to reduce government role. I don't deny it, under the Islamic philosophy also we will have to reduce government spending. But in a different manner where we will have to stick to our value system.

### **2. Great Role for the Market**

You allow the equilibrium prices to prevail. Prices will rise and spending will go down automatically. Higher prices, higher interest rates, higher currency depreciation and all these will ultimately lead to lower spending and since prices technically miss to take care of disarming objectively, therefore, it will not make a difference. We are not concerned about distributional impact of these higher prices as long as they help us reducing excessive absorption; it is all right.



### 3. Liberalize Foreign Trade

Of course, we see that when your currency is devalued, it will induce exports, but no import control is called for by the IMF. If, at all, you wish to have an import control, you should have a heavy average tariff on all imports. No discrimination between imports and exports. You allow all imports in the same manner, with a lower tariff rate or with a heavy tariff rate. So, what happens is that this would naturally give benefit to the rich and hurt the poor. How we will overcome it? And why do we talk of removing import controls? Are there developed countries without import control? Is there any industrial country around the world which can say they developed because they did not resort to protection? They did. Even Japan, Taiwan and South Korea. The countries which are mentioned most in the case of rapid economic development. Their history does not reflect absence of protectionism. So giving an advice that they have not practiced is giving a wrong advice. But it does not mean that we should resort to protection in any manner. We should provide protection to the industries in which the poor people are involved and not the big industries which are now getting protection. Because they become billionaires and the poor people become sufferers.

The fact is that this IMF strategy is going to hurt the poor. So, it is said that this strategy will sometimes affect the poorest kinds of people harshly. Why do they want to hurt the poor people most harshly? Who had given the rich people the right to decide that the poor should be hurt most harshly? And we realize that this strategy is to hurt them harshly. Why? Why do we ask this question? The reason is very simple. We all know that the solution is very necessary and the IMF strategy has the solution but the solution is preventive in a different way. It is just like saying, I have two feet, right foot and left foot and you come and tell me I order you to tie right foot and always walk with your left foot alone. Is that irrational ? Or somebody comes and says, I will tie your right hand or your left hand, and you always work with one hand. This is also irrational. So this is the irrationality of the IMF message. Because there is a number of factors which influence allocation and distribution of resources. There is a number of factors through which we can reduce excessive absorption of the society. But why IMF has to resort to only one prescription ? Why they are ordering the developing countries to use their left foot and not both their feet as we all know that this increases our efficiency and enables us to bear the burden better ? With only one foot I cannot bear the whole burden but when I use both my feet to carry weight I can do it better. If you rely only on the market which the IMF does, i.e. the left foot of society, and resort to a rise in

prices, the rise in prices will be higher, the rise in interest rates will be more and the current depreciation will be much greater. The result is that the poor people suffer, because the rich are able to pay the price. They have so much money they can buy whatever they want. Their consumption will not decline, except may be in a marginal manner, and they will of course be more competitive because these commodities that are engaged by IMF will lead to higher profits. Their profits will increase, their expenditure can vary and they don't suffer. The poor people suffer because they have fixed income. Their income will not rise and the IMF strategy keeps wages the same, and says that wages must be stabilized. If you adopt IMF strategy, you should not allow the wages to rise. If you do that you will be violating IMF strategy. So, normally in any society, fixed incomes remain stable and don't rise with the prices, and then on IMF instructions the governments are bound to see to it that wages don't rise. So the poor people have to pay higher while their incomes do not rise. The rich people, their income rises and they pay higher prices and their assets enable them to buy anything they want.

That is why we have read in the press all the time about IMF caused uprisings. Whenever an IMF mission comes; the government agrees to their program; they announce the program; and there are riots, and the government thinks to go back on the program. Even if some governments persists, let us say i.e. a dictatorship, and the government is determined to a certain program but still this program cannot be pursued for a long time because the government has to have an eye on the equity consideration. When the poor people suffer, the government has to be responsive particularly if the governments have to go for election periodically. Even dictatorship have to see what people are saying. They cannot keep them totally away from this equity consideration. So, the result is that even if the government follows this strategy under IMF pressure; afterwards, four or five years, they will go back on it. May be the conditions will have improved by then to some extent and the IMF also allows relaxation and the problem will arise again. So, this is only a short term strategy. No government can afford to disregard equity considerations for a long time. Even the US government is unable to do it and the UK government or German government, they are able to do it, and we also, the governments of developing countries cannot do it for a long time. Two, three or four years and then they will have the same problem once again.

## THE ISLAMIC RESTRUCTURING

The Islamic strategy, on the other hand, is more practical, more equitable, more growth oriented and it can be pursued over a longer period without political or economical difficulties. It would not be one sided, because for how long can you make a person walk on one foot, for a mile, or some strong persons can walk for two miles, but if you can make him walk on both feet, he can walk much longer and continue to walk with some rest in between. This is the position of the Islamic strategy. We try to use all variables that influence the allocation and distribution of resources and we do not depend only on the market. It does not mean that we eliminate the market or restrict it. We depend on the market also, but we use other elements of our strategy equally, so that we have greater success in realizing our goals. So, the market mechanism is there in Islamic economy supplemented by other mechanisms.

What else do we resort to ? Do we resort to regimentation and collectivization? No. There is no regimentation in Islamic economy. No collectivization. The only thing we do is to require the market mechanism to operate with certain concerns and those concerns are determined by our value framework. By our own cultural system. Therefore, it is more human.

Now, how does it operate ? Before you go to the market and express your votes through your ability to pay the price, you pass your claim on to the filter of resources through moral values. It is an important law of religion. If it does not pass this moral test, then I withdraw my claim before I go to the market. In other words, when you are lying down in the bed and thinking of purchasing certain thing, or in the morning, you are discussing with your wife and children what you are going to purchase, at that time the consideration comes. You have not gone to the market yet and you eliminate many of the claims before you go and when you go you have pure claims on resources, and therefore you don't impose as much pressure on resources as you would in a secularist system.

In the Islamic system there is a double way filters. One is the moral filter, through which you pass the claims on resources before you go to the market and then the second filter operates. In other words, my moral filter allows me to eat rice or wheat. All right, I go to the market. Either I have a specific taste that I don't like bread at all. That is a different matter. Then, there is a monopoly of rice in my family. But if I don't mind any one of the two, I see the prices. If the price of wheat had gone down, may be I will buy more wheat and less rice. So, in this matter, in a double layer of filters. Both filters are

operating at the same time. One filter siphons unnecessary claims on resources, thus we reduce pressure on the available resources, and improve the chance of the poor satisfying their needs. When you know there will be little difference between rich and poor, you all realize your claims. In my childhood when we went to the house of a rich man and we compared our house and his house, there was not much difference. We had two rooms, may be he would have three or four rooms. We used to sleep on the floor, spread a mattress at night and roll it up in the morning, may be he had one good bed and the children used to sleep on the floor in any room, and so, in other words, there was not much difference. So, you look at the floor; the ceiling, the decoration and ornaments at that time, there was not much difference.

I know there is now a vast difference in the way of living of the rich and the poor. Under the influence of Western culture e.g. conspicuous consumption has become a pre-landmark in our society and every body goes out of one's ability to spend more. In our childhood, we never heard a word, "we have nothing to wear" that we hear today, why ? Because we do not have anything new to wear. We may be having too many things to wear but nothing new to wear. This is a part of Western culture. This is not a part of our culture. There were a few cloths for special occasions and a few cloths for normal wear and the rich and the poor did not have much differences, though the rich may have a better cloth than those of poor. But they don't have a wall roof of cloths and still say I don't have nothing to wear. So, this expression was never heard at that time. Also in terms of furniture, we never change everything every one year or every two years, or other things in our life, we use to live a relatively simple life but now the things have completely changed.

This is one of the reasons why there is a lower rate of saving in our society. This lower rate of saving does not enable us to invest enough. Therefore, our rate of growth is low and thus, we borrow today from the West and create indebtedness unnecessarily or resort to money creation. If we have a higher rate of saving by living simple, then there is no problem. I think, even all needs of poor, even in Bangladesh, not to speak of a relatively better country like Egypt or Iran but even in Bangladesh, all the needs of poor people can be satisfied if the Muslim countries were to lead a simpler life so they don't put too much pressure on resources.

Of course, in a secularist society, you cannot induce people to do this. Why would a rich man lead a simple life ? He knows that he is going to die, be buried and then finished. His life has come to an end. In the Islamic culture, there is a motivation and this motivation is the Hereafter; that we are put accounted before God one day and therefore self-interest in our perspective are

not confined just to this world. On self-interests lines, in serving our interests here as well as in the heaven, we know that our interests in the Hereafter are served by living a simpler life here. In other words, if *Munkar* and *Nakir* were both to complain that this man consumes too much while one hundred poor people were unable to satisfy their basic needs, we know that our condition in the Hereafter is going to be bad. So, we have to keep one eye on the Hereafter and one eye on this world. Islam allows us to live as comfortably as we can. It does not prohibit us from living a comfortable living. But some thing beyond this. What is unnecessary for our comfort, what is may be called conspicuous consumption is not allowed. In other words anything for showing off or displaying is not allowed. *Fuqaha'* generally agree on this, and therefore it is simple life combined with the concept of accountability before God and a longer term perspective of human beings can help utilize resources more efficiently and equitably.

One may say you are a little bit off because moral reform takes time; allow us one or two years for this purpose to consider the whole thing. We **have** to remove our excessive absorption now and how do we do it ? Well, I agree, that this is a real problem and we have to combine this moral framework with government intervention in the economy. In other words, the government has to play an important role but in a different way, not in the way it has played in the capitalist economics or the socialist economics, but in an Islamic way. Not by spending more money but by trying to internalize the Islamic values in society. It has to educate people to discriminate between what is necessary and what is not. We have to define what we consider necessary and unnecessary consumption in the society, and then ban what is unnecessary and prevent its import. You will say, you don't know what is going on because people then smuggle the unnecessary goods, and their prices in the market will be higher because of smuggling, and therefore, there will be higher rate of profits and more and more imports of these commodities, and then the poor people will suffer any way.

This is not what we have to do. If we resort only to controls or higher tariff, they don't succeed. We have to raise the moral consciousness of the society at the same time, and this can be done, I am not pessimistic about it. In other words, if a rich man who wants to smuggle some goods, more expensive goods, for use by himself and for his family but he knows there are a hundred people who will angrily curse him, then he will desist, he will desist and he will not do it, and if he knows that among this one hundred people, there may be one mad man who may even attack him, he will desist even more. Of course, we do

not wish to allow this kind of attack. No, I am not recommending it or any thing like that, but it is possible, somebody may do it. Even if it does not happen, the hundred people are willing to curse and angrily look at this man and he will not do it. This is a part of moral upbringing that you don't like a person who disobey the values given by God and if he receives a sort of social boycott or at least nobody praises him of what he is doing, he will not do it, because people do this sort of conspicuous consumption because people call them great people.

You know very good why Japan and Taiwan have succeeded. It is primarily because of this. Their value system does not allow conspicuous consumption. Now it is changing in Japan. But there is a Japanese saying that the male who sticks out the most gets hit the hardest. So the person who tries to show himself in the society is disliked, and this is one of the reasons why the imports of many goods are not there in Japan. You will be surprised to know that the rate of tariff is lower. the average rate of tariff is lower than in many Western countries. But still the imports of many of these things don't exist in Japan or in Taiwan. Why ? Because of the social values. They have implemented their values and we have not. What matters is not whether you raise the tariff or you don't raise them, if the social values are brought into practice and the government creates an environment by means of proper policies, I think, this can be brought in about a month or two months, you can create a change. Whereby such a man will receive any look and he will desist from doing it. In fact he will not use the thing which he has at home, let alone the import of fresh goods for this purpose. So what we have talked about is the value system which serves as a filter along with prices and motivating system and an important role for the government in this respect.

There is one more thing which Islam has, while the capitalist system does not have. That is a different system of financial intermediation, and you will be surprised what moral values can do in our society. If the private sector does not get funds for luxury consumption, natural resources will be released for the need fulfillment of the poor, for the import of capital goods, for raw materials needed, for investment for production, and so on. What you will do by these means is reducing import. of luxury goods for the rich which the IMF strategy is unable to do by just raising prices. Then you are releasing resources for goods which are needed for investment. This will also bring about a better distribution of income as I discussed in our seminar yesterday.

What this will do in a way that it will reduce the import/export gap and it will also reduce the saving/investment gap. Why? Because when you

consume less you save more automatically and when you save more, naturally we have more funds available, more resources available for investments. When our imports go down, we will have greater ability to export, our export will also be high. But also we will clear off the market methods, which are not out of the Islamic strategy, then of course, we get a better prospect. Then, the governments will not be able to get money for unnecessary spending. Who is going to lend money to a government for defence ? You know this is one of the major problems in the sub-continent and in many other countries. Pakistan is spending too much on defence and India is spending too much on defence. The result is that both countries are facing difficulties and none is willing to reduce defence expenditure. This ability to spend more on defence, where does it come from ? Not from the resources of the society ! It is because of interest-based borrowing. Those countries which produce this defence arsenal, defence hardware, they are the ones which are giving suppliers' credit for this purpose and induce these countries to buy them. They make all kinds of fuss, we will not sell them to you and you beg them and hug them, and they will sell it anyway, and on top of that, they give you suppliers' credit for this purpose. So, the debt becomes more and more. India has a debt of 70 billion Dollars and Pakistan has a debt of how much I don't know because they don't reveal their defence indebtedness. The civilian debt is 18 billion Dollars but if you add its military debts, there are various estimates. Some people says 50 billion, some says 70 billion, some says 80 billion. Nobody knows how much is the total debt in Pakistan. So, if this kind of interest-based spending is not available, say for defence, the governments will be forced to resort to policies of peaceful existence and a substantial part of the spending will decline and the debt will go down. Unnecessary spending for various purposes must also decline by the same process. The government spends on fancy projects, wild elephant projects, all these things, who give money for this if the necessary funds are raised on the basis of profit and loss sharing ? If it will not be available, so naturally spending will go down, and this is not hypothetical.

You know, one of the countries in Africa spent 50 million Dollars on the inauguration of the President and this 50 million Dollars was almost 50% of that country's budget. It was able to borrow, so it spent money on the inauguration. Then there was the Manila example. In 1975-76, they held an IMF and World Bank meeting in Manila, and for these meetings they gave loans to many people to construct hotels. These were of course properly occupied during the meeting, but after the meeting for several years they remain unoccupied and the hotels suffered losses. What would happen if the profit and loss sharing system was applied? You know, Manila would have been forced

not to invite the IMF and the World Bank to hold the meeting and it would not do any harm to anybody. The IMF and World Bank would hold the meeting elsewhere and this country would have not suffered the burden of its extra debts.

An example from another country in Africa, a copper producing country, if constructed a dam on a lake or river. They had designed the project to produce electricity and take to another city which was several hundred kilometers away, and the money became available for this purpose on interest basis from commercial houses. After the project went into operation, it was discovered that the city had enough electricity already and they did not need more electricity, not certainly from such a far away distance, because the cost was much higher. Money would not be available, if Islamic financing instruments were applied, because in that case, the banks would also examine the project carefully. Now they are not doing this. There was a concept of sovereign debtor, the sovereign debtor is solvent. It can never become insolvent, therefore the banks were giving loans to the country and now they discover to their great loss that sovereign debtors can also become insolvent and the banks as a result reach great difficulty.

This will also reduce to corruption because if you resort to simple living then you don't need the extra money for which you resort to corruption. I have explained yesterday that if somebody wants to marry his daughter and he was to do it in less money, he will not take bribes, but if he knows that he will have to spent a lot of money for the wedding of his daughter, he will resort to corruption and this affects the efficiency and equity in the society.

Deficit does not get reduced in an interest system because there was money available, all the time; but when the governments are constrained, then they will be forced to reduce spending. This does not mean that an Islamic state will have to always balance the budget. No. Because for sure, all their productive projects will be able to get financing somehow or the other, but for unproductive items no finance will be available. The government can borrow and there is, in a manner cooperation between the private and public sector. Then of course, corruption will also go down. Because private sector will have an interest in reducing cost which otherwise does not exist, because when you work for the government, you have an Islamic obligation to protect the wealth of the *Ummah*. As a result, the export/import gap will go down and the saving/investment gap will also go down.



One of the reasons why saving rate is low is that the governments want to use deficit financing, and they are utilizing a substantial part of the savings of the private sector. But now, the situation is that the private sector will save more because of simple living and inability to get financing for conspicuous consumption and the government deficit will also be less. So you will have reduced the gap substantially. In fact, you will have eliminated it and you will have created a positive surplus in this manner in both respect.

The value system plus financial intermediation which Islam has given are both very effective. Many people say that the purpose of abolition of *riba* was to help the poor, who need to borrow and they cannot pay the interest and they go through great difficulty. This is all nonsense. Because at that time, the borrowing was mainly for business purposes. You know the caravan was to go for long distance from Makkah and Madinah to Yemen and Damascus to buy goods and this took several months to go and come back. First of all, they had to buy all the available goods from Makkah and to sell in Damascus or in Yemen and then they would use the proceeds to buy goods from there to sell in Makkah or Madinah and they need substantial financing for this purpose. You don't need so much financing now, because you can arrange supplies every fortnight or every week if you want, but they could never do this. They had to bear for long period and therefore the borrowing was mainly for business purposes, and Islam condemned it because of the injustice. Now I can tell you the fact is that a society, which does not abolish interest and resort to profit and loss sharing framework, cannot realize its goals at all, goals of needs fulfillment, goals of higher rate of growth, goals of equitable distribution of income and so on. None of these goals, which are given by Christianity, by Judaism, by many other religions as much as by Islam, can be realized except within the framework which only religion provides and that is why Islam was not stupid in abolishing *riba* or prohibiting it. Christianity did it, Judaism did it. Why ? Because they realize that these goals which religion promotes could not be realized without abolishing *riba*.

The only thing that remains to be discussed is the political implications of the unhealthy policies. Domestically, this excessive absorption, that we have created because of resorting to Western consumer culture and to their method of financial intermediation, has created imbalances, high rate of inflation, low rate of growth and high unemployment. This creates domestic political instability and no government is able to find a suitable solution. So, only those governments which clearly implement the Islamic strategy will be able to solve problems and will be able to survive in the future. Otherwise there will be

governments that will change after every few years and this will create instability and ample excuse to the armed forces to bring martial laws. If they wish to avoid martial law and to return back into power, they have to resort to Islamic strategy, so that they will be able to solve problems because the problems can be solved only within the framework of Islamic strategy. Any government which resort to the IMF strategy will face big riots and they will have to withdraw the program. The imbalance will continue to rise, it will not be able to borrow from IMF, it will have difficulties, it will become a failure. Therefore, we have to try to convince the IMF that this alternative strategy is there and it does not violate the basic principles of science and consistency. By reducing unnecessary spending, we will be able to depreciate our exchange rate less, we will have less inflation, we will have lower deficits and we will have lower saving/investment gap and mark lower import/export gap in our society. I am sure that if we present our case in a convincing manner, we can convince them and there will be no problem. So that is why the Prophet (Pbuh) prayed, "God, protect me from disbelief and poverty". You may be surprised that why the Prophet (Pbuh) would pray in this manner. A government which borrows too much or individuals who borrows too much to satisfy their conspicuous consumption or to finance their unnecessary spending, will ultimately not be able to fulfill their needs or the needs of their people. There will be different strategy in the society, there will be different groups, the poor and the rich and there will be a conflict between them; in this conflict who will suffer ? The poor will suffer and this is what happened in our society. Because the poor people are unable to satisfy their needs and therefore some turn to disbelief and instability. They say: we adopt Islam, we adopt Islam, and we have all these problems. But we abstain from the practical solution that Islam has given.

When we talk of Islam, let us be serious. Let us reduce our imbalance and employ our resources in an effective and productive manner so that we will be able to fulfill the needs of all and to remove the problems all people are facing and then there will be no question of this, "poverty may be almost like disbelief". Reduce your debt and you will be free, this is what we are unable to do now because when we borrow from Western countries, we have to beg before them, we have to kneel before them all the time, all the time these countries go to the group of creditor countries and beg them and they impose conditions that you will not do this, you will not do that, and one of these conditions which come indirectly is that you will not resort to applying real reforms needed in your societies. Actually what they are trying to do is to prevent the revival of Islamic teaching so that we cannot lead a free life, even though we are free, we cannot be free until we attain an economic freedom and

only way to attain economic freedom is to re-organize our society in a way that we do not have to borrow from them, and if we have to borrow, borrow so little that they will themselves come to ask us to lend us. But if we do not reduce our spending, our indebtedness will continue and our problem will keep on multiplying.

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## DISCUSSION

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### Chairman

I have been asked by Director General of Islamic Foundation to introduce the speaker and convey thanks and appreciation before the speaker began his lecture. Actually I feel that the discussions should follow if you agree since the talk is very interesting. Now, the Guest Speaker, of this afternoon session is Mohammed Umar Chapra. He is a Pakistani. He got his masters degree of Commerce from Karachi University in 1956 and thereafter within 3 years he got his Ph.D. from an American University and since then he served as a teacher in American universities. Then he came back after he was picked up by Saudis that he became the Advisor to the Saudi Arabian Monetary Agency. He has been continuing for the last two decades over there, and it is because Saudis are not releasing him from there, because he can talk on the same terms and guidelines with the American intellectuals, as you heard his intellectual high order, and he is still in Saudi Arabia. We are getting some type of benefit in a different way. I only say that he should be paid for that he is serving Saudi Arabia or in the Arab countries for long and one thing I am personally, terribly impressed, because he is an intellectual of high caliber and high order. He does not have the inferiority complex that we usually have, that Islamic economics cannot work, he is the man who can convince. In our country, many people are saying Islamic Banking cannot work and Islamic economics cannot work, and I personally feel that this man can come here and talk to our University teachers and to our great intellectuals and professionals, so that, by this talk form him, we really get the courage that our intellectuals are convinced that the Islamic economy and Islamic banking system is the solution, is the right solution of the problems of modern time. I, on behalf of you all, am very grateful to him for his arrival, I thank him and wish that he comes many times in future. We seek his speeches and voice more particularly in the University campuses and I again thank him. If you agree, in the discussion, we may ask questions; it is not necessary that many people have to stay for a discussion of this type. I am very happy still the house is full. It is not necessary that the house has to be full. So if you agree, I propose that you continue the discussion even after. What is your reaction ? O. K. You agree. Then it will continue.

## **Question**

What is the role of International Islamic Organization ?

## **Chapra**

In the first place you should realize that these international bodies are not equipped, nor meant, nor indulged into formulating policies for the individual countries. They were not established for that purpose at all. They are not established for that reason. They were established to provide certain platforms for cooperation among the members of the organization. So they can make a good platform for good cooperation. They are useful as they accommodate ideas for cooperation. Out of them many useful ideas came about. One of these useful ideas was to establish the Islamic Development Bank as an institution that provides financing on Islamic basis, no matter how little and small it may be. The whole Bank is a small bank. Now in addition to the Islamic Development Bank, there are other platforms and other organizations or something like that were created, also the OIC. This is basically on the basis of the Makkah Declaration which talks about economic cooperation among the Muslim countries. There was a permanent committee for economic cooperation, established, headed by the President of Turkey. There was another committee that is also permanent on technological cooperation among the Muslim countries headed by the President of Pakistan. Many ideas come through these committees and new ventures also come at a slow pace but they do come, e.g. this idea of promoting non-conventional trade among the Muslim countries, this is not the trade of oil or main products but of those products of which the countries are not famous but they can be encouraged. Promoting their exports among the Muslim countries. This is a program which was established, and the IDB is involved in this program. There is another program for providing guarantees for export financing among the member countries which is now in the last phase of its establishment and is going to come in, I am sure, very soon.

Another program which IDB is sponsoring is establishing some kind of reach out to the private sector through a financing approach and at the same time providing liquidity for Islamic Banks. This is called the Islamic Banks Portfolio.

Ideas of these kinds come always through these platforms and although international organizations are not meant for more than that. Don't expect more than that from any of these organizations, even other non-Muslim organizations

will not come and solve the problems of Bangladesh, or solve the problems of Lebanon. It is only the Bangladeshis who can solve their problems. Nobody else can do that, certainly not any international organizations. As long as we are behind on those ideas we are bound to be dependent, and excuse me for using the word that applies to every country and not to Bangladesh alone. It applies to thirty-four Muslim countries to be "beggars".

### **Question**

To what extent a common market of the Muslim countries would help in solving the indebtedness problem of the indebted Muslim countries ?

### **Chapra**

Well, a common Muslim market would enable Muslim countries to export more. This means that they will be able to find market for their products. In other words, by means of giving most favored treatment to other Muslim countries, this can be arranged. But we must realize that the main problem of the countries is not that they are not able to find markets for their goods. Main problem is that they do not have the capacity or they are not able to compete and this is an internal problem, a domestic problem of various countries. Why don't they have the capacity? Because they spend too much and save too little. So they are able to invest very little and when there is little investment, the capacity to produce does not rise enough to be able to export more. This is one of the problems that the countries cannot export more: because they do not have enough capacity. So in order to increase their exports, they have to consume less, save more and invest more. This will increase their export.

The other thing is their inability to compete in the international market. This requires a great deal of policy change, domestic policy change in their countries to update their technology and reduce the rate of inflation. This means, the government should re-organize the fiscal policy, the private sector should resort to simple living, so that the pressure on resources is reduced and inflation does down. Once the rate of inflation goes down, the competitiveness of the country will increase. The other thing is that the labor force is not competitive enough. In other words, it does not have the competence to efficiently produce goods that would be able to compete in the world market. For this purpose we need training institutions. We have to train our manpower to produce more. The third great factor is that this manpower needs technology, the proper tools to produce. For this, again we are required to re-organize our

economy in such a manner that small producers, who are inefficient producers, would become better producers by means of training as well as better tools. The governments can play an important role in all these aspects. Which country from outside can help in this matter except the country itself ? So, unless we, ourselves, are willing to improve ourselves, nobody can do anything. But, nevertheless, I must admit that a common market of Muslim countries will be very helpful. I mean, it has been indicated that OIC is trying to do various things in this direction and this will be ultimately helpful.

### **Question**

It is alleged that Saudi Arabia invested their maximum funds in the capitalist countries other than Muslim countries. Is it true ? If it is, please state reasons ?

### **Chapra**

Well, it is true. But the reasons are: you must realize that the oil income became suddenly available to Saudi Arabia after the year 1974 and only for a few years, five or six years of extra oil income. The investment of this in a productive way, in other Muslim countries, would have taken a lot of time. You know when you invest money in a productive project, the country has to prepare a feasibility study. It has to be examined by the country concerned, and then it has to be studied and approved by the financing country. It takes a lot of time, while the funds are to be immediately invested. Secondly, the important consideration was that, this extra income will be available for only a few years. After that Saudi Arabia will go into a deficit and will need the money. So, it is to be invested in a manner that it will remain liquid enough, so that we can draw upon it as soon as we need it. If this income has become permanently available, then may be it could be put in long term investments and we could forget about it for some time and the returns would start flowing. But, this opportunity was not available. You know that the extra oil income has started in 1974-75 and it went up to 1981-82, five or six years. Thereafter, Saudi Arabia has had a deficit of all the years and all the savings that we had in those five or six years are now gone. So, it could not be invested in longterm projects. Short term investment was the only thing and this was easily available in Western Banks. I don't say that this is the best thing, but at that time given the considerations that the income was easily available, and the infrastructure was not available to study projects, feasibility studies and to invest in long term projects, we have chosen the easiest way.

### **Question**

In the context of Bangladesh, we are not self-sufficient. We have to have loans from Western countries and it is not possible to get loans without interest which is seriously prohibited by Islam, what is the way by which we can get loans from Western countries we will be saved from interest ?

### **Chapra**

As I indicated in my lecture, one of the most important ways is to reduce all unnecessary spending. This will increase our savings and enable us to invest within the country from our own saving. When we reduce our consumption, our imports will automatically decline. Imports of all unnecessary goods should be cut off. The result is that the import/export gap will decline and even if we do not have surplus, the gap will be smaller. Now, there is a small gap which we are unable to take care of and we have to borrow from Western countries to fill that gap. Then, in that case the *Fuqaha'* would permit borrowing on the basis of interest. We have to realize that in the case of emerging (*idtirar*), that is when we are forced, we have no other way out.



**PART VI**  
**ISSUES IN RESEARCH AND**  
**TEACHING OF ISLAMIC**  
**ECONOMICS**

## CHAPTER TWENTY- FOUR

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# TEACHING PROGRAMS IN ISLAMIC ECONOMICS - A COMPARATIVE STUDY

*Munawar Iqbal*

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## 1. INTRODUCTION

Islamic economics is a new discipline but it is gaining strength and maturity very quickly. The development of the discipline in the last few years has led to the establishment of teaching and training programs at a number of places and in several countries. With increasing literature of high quality becoming available and due to tremendous interest in the area, it is hoped that several new programs will crop up in near future. Therefore, it is a very crucial stage in the development of the discipline. The seed has been sown but the crop is years of hard work ahead. This is the time for fertilizing and watering on the one hand and weeding and pruning on the other. While it is imperative to increase the present effort manifold, it is also important to keep a vigilant eye on the experiments underway in order to ensure that they achieve the objectives for which they are designed. It is with this spirit that the present exercise of a comparative study of the major teaching programs in Islamic economics is being undertaken.

Islamic economics was introduced initially as one of the subjects in degree programs in economics and *Shari'ah* faculties in some universities. It comprised of only one or two one-semester courses. The number of courses gradually increased. It was only in early 80s that full-fledged degree programs in Islamic economics were introduced. At present, there are three kinds of teaching programs which are in vogue:

- a) Partial program
- b) Undergraduate programs and

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c) Graduate programs.

Mention must also be made of some training programs designed to meet short-term needs of the process of Islamization. In the following pages we will say a few words about each of these. But before doing that we present some broad objectives which the teaching programs should attempt to achieve. It will be with reference to these that the existing programs shall be evaluated.

## **2. OBJECTIVES OF TEACHING PROGRAMS IN ISLAMIC ECONOMICS**

Teaching of economics in major universities of most of the Muslim countries inherited or borrowed its style from Western universities. Its approach has been secular and contents purely mundane. Such a program is quite in line with the materialistic approach of secular countries but is in flagrant contradiction with the Islamic system. In an Islamic society all disciplines should have a profound imprint of Islam so as to provide Islamic vision for those involved. Before listing the objectives of teaching programs in Islamic economics, some general remarks about the existing education system may be useful. The major defects from which the education system in most of the Muslim countries suffer may be identified as follows:

Firstly, the education system has been bifurcated into the so called "modern" education and religious education. The two are being imparted through entirely independent and completely different institutional set-up with no interaction between them. In most of the Muslim countries, religious education is given through "*madrassas*" while the colleges and universities have been reserved for the so called "modern education".

Secondly, the religious education is given neither patronage nor recognition. While the university education is run by state machinery, the religious education has been left to voluntary institution. Whatever public fund are available flow to public schools/colleges while the religious institutions are left at the mercy of philanthropists. Similarly the graduates of "*deed madrasas*" receive no official recognition. Almost all public jobs go to the graduates of colleges/universities. The graduates of "*madrasa*" have to survive on very meager and irregular allowances in the informal sector. They have no status in the society and are often looked down upon by the "educated class". The

natural result has been that most of the talent flow to the secular system of education.

Thirdly, the quality of education has been pathetically low. The curriculum and syllabi for the university education are out-dated. The system of education and examination is such that the critical and ingenuitive abilities of the students are not promoted. The situation in "*madrassa*" education is even worse. The system of education and examination is very loose. Quite often it is very informal. Even curricula and syllabi are not standardized. They vary from one *madrassa* to another both in coverage and standard. There is hardly any place for the study of modern developments, new technology or research.

The brief review of the problems given in the previous paragraphs provide useful insights for chalking out a strategy for their solution. Any prescription for the treatment of the ailing system must include the following elements:-

- i) The so-called "modern" education and the religious education system must be fused together.
- ii) The education should be purpose-oriented. It should be considered as *Ibada* and must result in a better understanding of Islamic faith. It should aim at character-building and spiritual elevation along with an increase in knowledge.
- iii) The quality of education should be improved so as to produce people who are not only qualified in modern science and technology but are also imbued with Islamic knowledge, character and spirit. They should have all the necessary qualities which would enable them to reconstruct modern knowledge on the foundations of Islam and to suggest ways and means for putting it into practice.

In the light of these broad principles the teaching programs in Islamic economics should aim at the following:-

- i) Knowledge of Arabic - good enough to enable the students to have a direct access to classical Islamic literature and original sources.
- ii) Knowledge of Islamic, *Shari'ah* in general and Islamic economics in particular.

- iii) Knowledge of traditional economics.
- iv) Knowledge of quantitative tools of analysis.
- v) Ability to critically evaluate economic theory.
- vi) To create professional awareness about the need for a new approach towards the science of economics.
- vii) To motivate the students to participate in the process of Islamization of knowledge.
- viii) To prepare the student for the market in order to meet the requirements of Islamization efforts on the one hand and to provide decent means of living for the graduates on the other hand.

### **3. SALIENT FEATURES OF VARIOUS KINDS OF TEACHING PROGRAMS IN ISLAMIC ECONOMICS**

#### **A. Partial Program**

As mentioned in section one, there are four kinds of programs being offered. Partial programs are the least ambitious among these. They involve only one or two courses in Islamic economics. Contents of these courses vary but they are naturally of a very elementary level. Typical contents of a course of this nature include the following:

Economic Values and System of Islam: (Punjab University, Pakistan).

#### ***1. Meaning and Scope of Islamic Economics***

Economic System of Islam as a part of its overall philosophy of life.

- Sources of Islamic economic concepts.
- Islamic Economics and Modern Economics.

#### ***2. Basic Values and Principles***

Concepts of Equality (مساواة), brotherhood (إخوة) Justice (عدل).

*Taqwa* (تقوى), benevolence (إحسان) and cooperation (تعاون) as basis of all economic policies.

Concept of *Halal* and *Haram* and its application to economic activities.

Islamic code of business ethics.

### **3. *Islam and other Economic System***

The economic System - its meaning and functions.

A comparative analysis of the broad economic features of Islam, Capitalism and Socialism.

### **4. *Consumption***

- Importance and principles of consumption in Islam.
- Principles of moderation and its economic significance.
- Behavior of the Muslim Consumer.
- Production:

### **5. *Production***

Islamic approach to production.

Areas of private and public ownership in Islam Ownership and cultivation of Land.

Forms of business organizations - *Mudarba* and *Shirakat*.

### **6. *Dignity of Labor***

Importance, dignity and rights of labor in Islam.

Measures to improve labor - capital relationship.

## **7. Product Pricing**

- Concept of just price in Islam.
- Prohibition of exploitative prices - monopolistic, speculative, etc.
- Regulation and control of prices.
- . Behavior of firms under the influence of Islamic spirit.

## **8. Principles about Distribution of National Income and Wealth**

Qur'anic emphasis on the circulation of wealth among all sections of the community.

Limits on rents and profits. Islamic approach to determination of wages.

Measures against accumulation of personal wealth - the institutions of *zakah* (زكاة), *sadaqat* (صدقات), *khairat* (خيرات) and *awqaf* (أوقاف)

Distributional aspects of the Islamic Law of inheritance.

State's powers for further measures. Rights of specified sections of the community to receive pensions, Death duties.

The revolutionary concepts of (*Fadl* ).

## **9. Interest-Free Banking and Insurance**

Prohibition of interest and its economic and social significance.

Interest-Free Banking.

Introduction of interest-free investment and deposit accounts in Pakistan.

Insurance and Islam.



## **10. Public Finance, Fiscal Policy and Budgeting**

- Taxation in Islam.
- The institution of "*Baitul Mal*".
- Principles of Public Expenditure.
- The institution of *zakah*.
- *Zakat* as an instrument of Fiscal Policy.
- The *Zakah* and *Ushr* Ordinance, 1980.

## **11. International Trade**

- Islamic approach to trade among nations.
- New world economic order and Islam.

## **12. Economic Development and Planning**

- Islam's keen interest in economic development.
- Encouragement of technology, Inventions and innovations.
- Nature and Importance of Economics Planning in Islam.
- Goals for development policy in Islam.

## **13. Role of the State**

- Maintenance of Law and order;
- Security of life and property; Social security;
- provision of basic necessities of life;
- Social overhead capital, education and *tabling*,
- Economic development; social justice.

#### ***14. Social Justice in Islam***

Social justice in Islam - goals, strategies and instruments.

#### ***15. Role of Muslim Economists***

Muslim civilization and the development of world trade, commerce, agriculture, technology and transport.

Contribution of Muslim Economists to the development of Economics as a science.

#### ***16. Islamization Process in Pakistan***

- The character and objective of an Islamic Economy.
- The choice of an appropriate Policy Package.
- The Islamic Policy Package.

It goes without saying that partial programs cannot help much in the objective of Islamization of knowledge. However, they have their own importance. They are a good precursor to full-fledged degree programs where introduction of the latter is not possible for one reason or the other. They are like the first few drops of rain that herald the downpour of heavy torrents. The contents of these courses can however, be improved. Assuming only two one semester courses to be offered we suggest the following sequence of courses:

1. Economic Doctrines of Islam
2. Introduction to Islamic Economic Theory.

In addition every teacher should be asked to introduce Islamic elements in the conventional courses as far as possible. The suggested contents of the two courses are given below:

##### ***1. Economic Doctrines of Islam***

1. What is Islamic Economics and how does it differ from secular economics.

2. Islamic Economic System: A comparative study. Salient features of the Islamic Economic System.
3. Islamic principles guiding consumption and production.
4. Guidelines from *shari'ah* for the theory of exchange.
5. The concept of ownership and its limits in an Islamic framework.
6. The redistribution mechanism in an Islamic economy.
7. The concept of "*riba*", its interpretations and implications.
8. Alternative institutions to interest-based operations and their justification in *shari'ah*.
9. *Zakah* and its economic role: The place of *zakah* in Islamic Fiscal Policy, its effects on consumption, saving and investment activity in the country saving and investment activity in the country.
10. Institutions of *ushr*, *kheraj*, *jizya*, etc. as sources of public revenue.
11. The economic role of state in an Islamic economy.
12. Muslim Economic Thinking: A Survey of Contemporary Literature.

## ***2. Introduction to Islamic Economic Theory***

1. Consumer behavior in Islamic Perspective and its effect on demand.
2. Behavior of firm in Islamic framework and its effect on supply.
3. Market Equilibrium
4. Islamic view on Market Structure - Perfect competition, Monopoly, oligopoly, monopolistic competition.
5. Factors of Production and Determination of their Return.
6. Distributive Justice and Need Fulfillment.
7. Measurement of gross and Net National Product: Some consideration from Islamic perspective.
8. Introduction to macro-economic modeling for an Islamic economy.
9. Consumption, saving and Investment functions in an Islamic economy.
10. Interest-Free Banking and Monetary Policy.
11. Public Sector Economics in Islamic Economy.

12. Project evaluation from Islamic perspective.
13. Guidelines for international trade from Islamic *shari'ah*.
14. Concept of economic development in Islamic framework.

## **B. Undergraduate Programs**

Undergraduate programs most important for the achievement of the desired objectives. However, designing of a program which can accommodate multifarious needs of the discipline is not an easy task.

In order to give a good understanding of traditional economics, a firm knowledge of relevant *shari'ah* subjects, quantitative methods and other analytical techniques and modern technology relating to the science of economics, and to prepare the graduates for the market, requires inclusion of a large number of subjects in the curriculum. There is also the language requirement. In order to have excess to the rich heritage of *shari'ah* knowledge the students must have a good knowledge of Arabic. At the same time they should also have a good knowledge of English language because most of the traditional economics literature is in English. Since one of the objective is to merge "*Madrasa*" education and college education, the different backgrounds with which graduates from these two streams come, places additional constraints on the design of degree program in Islamic Economics. One has to pull out a reasonably homogeneous group, one has to come up with a course-mix which can produce graduates who can take up the challenge of promoting the discipline of Islamic economics and meet the market requirements emerging from the efforts of Islamization. One has to solve the problem of medium of instruction and preparation of bilingual graduates.

Given the time constraint, fitting in all the requirements is a very difficult task. Different institution have tried to cope with these requirements in different ways all of which involve a compromise in one front or other. In this section we review the programs of four major institutions engaged in undergraduate teaching. These are, International Institute of Islamic Economics, International Islamic University, Islamabad, Pakistan; Kulliyya of Economics, International Islamic University, Malaysia ; Department of Economics, Faculty of *Shari'ah*, Imam Muhammad University, Riyadh, Saudi Arabia and Department of Economics, Imam Saud University, Tehran, Iran. A summary [picture about the structure of undergraduate programs in Islamic Economics in

these institutions is given in Table-1. The detailed curricula for these programs are given in Annexure-1.

Table 1

**STRUCTURE OF UNDERGRADUATE PROGRAMS:  
A COMPARATIVE STATEMENT**

Sr.	Particulars	IIIE Islamabad	IU Malaysia	Imam Muhammad University, Riyadh	Imam Sadiq University, Tehran
1.	Duration of the Program	4 years	4 years	4 years	5 years
2.	Medium of Instruction	English/ Arabic	English/ Arabic	Arabic	Persian
3.	Credit Hours Required of which	216	134	153	200
	i. <i>Shari'ah</i> subjects (%)	39 (18.05)	28 (20.09)	64 (41.85)	69 (34.5)
	ii. Economics (%)	84 (38.88)	63 (47.01)	43 (28.10)	45 (22.5)
	iii. Complementary (%)	24 (11.11)	27 (20.14)	21 (13.72)	8 (4.0)
	iv. Language (%)	69 (31.94)	16 (11.95)	25 (16.33)	78 (39.0)
4.	Number of one Semester Courses	56	48	59	82
5.	Average Number of courses per Semester	7	6	7.4	8.2
6.	Average Hours of Instruction per week	27	17	19	20

Except for Imam Sadiq University, all programs are of four years duration after higher secondary school level. The program of IIIE appears to be the most intensive in the sense that it requires completion of 216 credit hours. Hifz requirements and some non-credit courses are in addition to these. It

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\* The legal requirement is not expressed in terms of credit hours. However, the required courses involve 216 hours of class-room instruction. For purposes of comparison, a uniform language has been adopted.

involves 27 hours of class-room instruction per week. The most extensive program is the one of Imam Sadiq University, Tehran, spreading over five years and requiring 82 one semester courses. The program of Kulliya of Economics, IIU Malaysia is more traditional in the sense that it follows the usual work load that is in vogue in most of the Western University (which is in the range of 120-135 credit hours). The average number of courses to be taken per semester ranges between 6 to 8.2 in the four institution under review.

From a study of the composition of these programs and of their course contents, two distinct models seem to emerge. The programs of Imam Sadiq University and of Imam Muhammad University place much more importance on *shari'ah* subjects as compared to the programs of IIIE, Pakistan and IIU, Malaysia. The relative weight of *shari'ah* subjects is almost double in the former two programs as compared to the later two. The case of economic subjects is exactly reverse. The result is that the graduates produced by the first model would lack sufficient background in economics while the graduates produced by the second model would be weak in their *shari'ah* background. Finding the right balance between the two is the most important issue in teaching of Islamic economics.

Within the second model, the relative share of economics and related subjects which include statistics, mathematics, quantitative methods, etc. is higher in case of IIU, Malaysia (67% as compared to 50%) but in absolute terms IIIE program has a larger component of economics and complementary subjects (108 credit hours as compared to 90 credit houses). Therefore, one can safely conclude that in terms of economics the program of IIIE is the strongest. It also devotes a lot of time to languages i.e. 69 credit hours which again are the highest in the four year period. The problem with the IIIE program is that it has a very high work load which may not be sustainable in the long run. Secondly, the *shari'ah* component of the program is rather weak. While the graduates of IIIE can be compared to the graduates of any reputable university in terms of their background in economics, their *shari'ah* background remains much lower than the professed objective of producing scholars who can serve as the vanguards of efforts to Islamize knowledge.

Another objective which the program has not been able to achieve is the merger of the college and *madrassa* streams of students. Again the reason seems to be that the program is heavy on the technical side from the very start which the *madrassa* students with very poor background in this area find difficult to live with.

A feature which is common to all the programs is the lack of options available to students. The program of IIU Malaysia does provide some options but they are also within the area of economics and business. At an undergraduate level so much concentration is perhaps undesirable. Furthermore, within the discipline itself if some diversification can be provided, it will suit the varying aptitudes of the students better.

In the light of this discussion we are of the view that some improvements are required in the undergraduate programs presently in vogue. We offer the following suggestions for improvement:

1. The work load should not exceed 150 credit hours in total and 20 in one semester.
2. A more judicious balance between economics and *shari'ah* subjects should be maintained. In this regard, it should be remembered that since the degree to be given is in economics, it should not be dominated by *shari'ah* subjects. However, *shari'ah* component should be strong enough to produce the kind of blend that Islamic economics aims at.
3. It is desirable to cater to varying aptitudes of students. It can be achieved by introducing the system of majors. Initially two majors i.e. major in economics and a major in *fiqh* can be introduced. More majors can be added in due course.
4. Some optional subjects from other disciplines such as Islamic history, sociology, philosophy, political science, law, business management, accounting, etc., may be allowed. This will help broadening the outlook of graduates.

### **New Proposed Structure of Undergraduate Programs in Islamic Economics**

In the light of the above remarks, we have attempted to design a slightly modified program for undergraduate teaching in Islamic economics. The structure of a four year program leading to a Bachelors degree in economics is given in Table-2 while the suggested curriculum is given in Table-3

Table 2

**PROPOSED STRUCTURE FOR A B. A. DEGREE  
PROGRAM IN ISLAMIC ECONOMICS**

Credit Hour Required				
Subjects	Core	Major in Economics	Major in <i>Fiqh</i>	Double Major
<i>Shari'ah</i> subjects	24	24+12 = 36	24+24 = 48	24+24 = 48
Economics	36	36+24 = 60	36+12 = 48	36+24 = 60
Complementary subjects	15	15	15	15
Language (Arabic & English)	21	21	21	21
Optional subjects	-	15	15	18
Total	96	96+54 = 150	96+54 = 150	96+69 = 165

**COURSE SUBJECTS (TO BE TAKEN BY ALL)**

Subject	Credit Hour
<i>Shari'ah</i> subjects	
Ulum al Qur'an I	
Ulum al Qur'an II	
Ulum al <i>Hadith</i> I	
Ulum al <i>Hadith</i> II	3
<i>Usul al Fiqh</i> I	3
<i>Usul al Fiqh</i> II	3
<i>Fiqh</i> al Muamalat I	3
<i>Fiqh</i> al Muamalat II	3
Economics	
Micro Economics I	3
Macro Economics I	3
Micro Economics II	3
Macro Economics II	3
Money and Banking	3



Subjects	Credit hours
Public Finance	3
International Economics	3
Economic Development and Planning	3
History of Economics Thought	3
Comparative Economic System	3
Contemporary Islamic Economics	3
Economic Survey of Muslim Countries	3
Complementary Subjects	
Statistics I	3
Statistics II	3
Basic Mathematics	3
Mathematics for Economists	3
Introduction to Computers	3
Optional Subjects	
Five / six courses to be selected as follows:-	
1. Economics major must select at least two from List-1.	
2. <i>Fiqh</i> major must select at least two from list-2	
3. Double major must select at least two from each of List-1 and 2.	
4. Rest of the courses may be selected from list.	

In many countries there are some local course requirements determined by the government. We suggest that these should be accommodated within the 150 hours. However, in exceptional cases the work load may be marginally increased.

The time reserved for languages (i.e. 21 hours) should be divided between English and Arabic for each student depending upon his level in these two languages. For example students coming from college stream would take more Arabic while students coming from *madrassa* stream would take more English.

For optional subjects three separate lists have been suggested. Out of the five optional courses, the students with Economics major must take at least two courses from first list. Similarly students with *Fiqh* major must take at least two courses from the second list. Students with Double Major should take two courses from each of these lists. The rest of the optional courses may be taken from any of the three lists. It is to be noted that these lists are only indicative.

More courses can be added to each of these lists. Each department may also choose only a few of these to be offered if facilities do not exist to *offer* all.

### **C. GRADUATE PROGRAMS**

Graduate programs in Islamic economics have been stated in IIIIE, and Faculties of *Shari'ah* at *Ummul Qura* University, Makkah and Imam Muhammad University in Riyadh. All these programs are new and it may be a little premature to evaluate them. WE will only give a couple of remarks.

The same two models, i.e., *Shari'ah* dominance in the programs of Imam Muhammad University and Ummul Qura University and dominance of economics in the program of IIIIE are observed.

Most of the material available in Islamic economics literature can be covered at the undergraduate level. Therefore, enough graduate level material is at present not being covered. This aspect can only be improved with the passage of time. For this very reason, there are some people, who have some reservations about starting graduate programs at this stage. The other opinion is that graduate programs will themselves lead to good quality papers, dissertations and researches. They will also be useful for producing teachers for undergraduate programs. Next few years will show the product of graduate programs and an evaluation can then be made more objectively.

### **D. TRAINING PROGRAMS**

Training programs are meant to cater to the manpower requirements of the process of Islamization. In the field of teaching itself, the most severe constraint has been the availability of qualified manpower. The present generation of economists had little or no formal education in Islamic economics or subjects necessary for it. In order to meet the immediate requirements, some reorientation programs are needed. A beginning in this regard was made by IIIIE in 1984 by conducting a two-week refresher course for teachers of Islamic economics from Pakistani universities. The contents of this course are given in Annexure-2. This year another refresher course with international coverage has been planned under the joint auspices of IIIIE and the Islamic Research and Training Institute of the Islamic Development Bank, Jeddah.

While these programs are a good beginning, a two-week program can hardly be considered sufficient to provide the teachers of Islamic economics the

kind of orientation required. A cursory look at the course contents would reveal that covering all that ground in two weeks is a tall order. Only a broad brush treatment is possible. However, the problem is that on-the-job training programs cannot be conducted for much longer periods. Therefore, one has to settle for short training programs of 2-4 weeks duration and hope to create interest among the participants to further increase the knowledge imparted within that limited period on a self-study basis and/or through follow-up courses.

We are however, of the view that in order to meet the immediate requirements some more efforts have to be made. We have to start some crash programs: We suggest the following two programs:

1. One Year Diploma in Shari'ah/Islamic economics for Graduates of Economics.
2. One Year Diploma in economics for *Shari'ah* Graduates.

Proposed structures of these diploma programs are given in Tables 4 and 5 respectively.

The Diploma in Economics for *Shari'ah* Graduates will be very useful in assimilating *madrassa* students in the degree programs. They may be required to complete this diploma before entering the degree programs. This will also be useful for *shari'ah* experts teaching *fiqh* courses to economist or involved in research on contemporary economic problems. These diploma programs will go a long way in bridging the communication gap that presently exists between economists and *Fuqaha*. They can then work together to find Islamic solution to contemporary economic problems in a better way.

**Table 4**

#### **LIST OF COURSES FOR A ONE-YEAR DIPLOMA IN ECONOMIC THEORY FOR *SHARI'AH* GRADUATES**

##### **First Term**

1. English Language I
2. English Language II

3. Basic Economic Concepts
4. Introduction Theory
5. Money and Banking
6. Public Finance.

### **Second Term**

1. Microeconomic Analysis
2. Macroeconomic Analysis
3. International Economics / International Economics Institutions
4. Development and Planning
5. Islamic Economics
6. Comparative Economic Systems

### **Summer**

Summer will be required only for deficiency courses in language or other subjects, if any.

**Table 5**

## **LIST OF COURSES FOR A ONE-YEAR DIPLOMA IN *SHARI'AH* FOR ECONOMIC GRADUATES**

### **First Term**

1. Arabic Language I
2. Arabic Language II
3. *Tafseer*
4. *Usul al-Hadith*
5. *Usul al-Fiqh*
6. History of Islamic Economic Thought.

## Second Term

1. *Maqasid al-Shari'ah*
2. *Fiqh al-Muamilat*
3. *Fiqh* for Economists I
4. *Fiqh* for Economists II
5. Introduction to Islamic Economic Theory
6. Readings in Contemporary Islamic Economics.

## Summer

Summer will be required only for deficiency courses in language or other subjects, if any.

Another area for training programs is to cater for the provision of suitably qualified manpower for Islamic banking. A beginning was made in this regard by the International Federation of Islamic Bank which established an International Institute of Islamic Banking and Economics in Cyprus. The IIIE started a diploma program in Islamic banking. Unfortunately, the Institute ran into financial problems and was closed down in 1984. The gap created by the cessation of this program has not yet been filled.

IIIE started a 'Senior Officers Training Program (SOTP) in Islamic Economic Doctrines and their Practical Application in 1986. This is a 4-week program meant for senior officers of economic ministries and bank executives. The contents of this program are given in Annexure-3. So far three such programs have been conducted. The course is reining very successfully and is creating a very good impact. Given sufficient resources, the Institute plans to offer this program on an international level. Since this program is meant for senior officers the need for similar programs for middle level management of Islamic banks is still there.

### Annexure 1-C

#### CURRICULUM FOR THE UNDERGRADUATE PROGRAM AT IMAM MUHAMMAD UNIVERSITY, RIYADH, SAUDI ARABIA

I-Semester		II-Semester	
Course Title	No. of Credits	Course Title	No. of Credits
<b>First Year</b>			
Al-Qur'an Al-Karim	1	Al-Qur'an Al-Karim	1
Tafseer and Ulum-Al-Qur'an	6	Al-Fiqh and Al-Siyasah Al-Shari'ah	2
Al-Tawheed	2	Mathematics for Economists	3
Islamic Studies	2	Basic Economics Macro	3
Basic Economics Micro	3	Accounting	2
Principles of Accounting	2	Principles of Business Administration	2
English Language	<u>3</u> 19	Arabic Language	4
		English Language	<u>3</u> 20
<b>Second Year</b>			
Al-Qur'an Al-Karim	1	Al-Qur'an Al-Karim	1
<i>Al-Fiqh</i> and Al-Siyasah Al-Shari'ah	4	Al-Tafseer and Al-Ulum-Al-Qur'an	<b>6</b>
Islamic Studies	2	Usul-Al-Fiqh and Principles of <i>Fiqh</i>	4
Micro-Economic Analysis	3	Islamic View of Public Revenue	3
Principle of Statistics	2	Statistics Analysis	2
Arabic Language	4	English Language	3
English Language	<u>3</u> 19		19
<b>Third Year</b>			
Al-Qur'an Al-Karim	1	Al-Qur'an Al-Karim	1
Al Hadith	6	Al-Fiqh and Al-Siyasah Al-Shari'ah	4

Usul-Al-Fiqh and Principles of <i>Fiqh</i>	4	Islamic Studies	2
Macroeconomics Analysis	3	Money and Banking	3
Economic History for Society	2	International Economics	3
Mercantile Law and Companies	2	History of Islamic Economic Thought	3
English Language	$\frac{2}{20}$	English Language	$\frac{3}{19}$
Fourth Year			
Al-Qur'an Al-Karim	1	Al-Qur'an Al-Karim	1
Al-Hadith	3	Al-Hadith	3
Al-Fiqh and Al-Siyasah Al-Shari'ah	2	Al-Fiqh and Al-Siyasah Al-Shari'ah	21
Islamic Studies	1	Islamic Studies	1
Econometrics	3	Theo of Distribution	3
Economic Development and Planning	3	Mathematical Economics	3
Project Evaluation	2	Islamic Economics Seminar Course	2
Islamic Economics (Theory)	3	Saudi Arabian Economy and the Economies of Islamic World	$\frac{3}{18}$
Thesis	$\frac{1}{19}$		
Total Hours in 4 years = 39+38+39+37 =153			
Total Subjects in 4 years = 15+13+14+17 = 59			

## Annexure 1-D

### CURRICULUM FOR THE B. A. DEGREE AT IMAM SADIQ UNIVERSITY, TEHRAN, IRAN

I – Term		H – Term	
Course Title	No. of Credits	Course Title	No. of Credits
<b>First Year</b>			
<i>Tajweed</i>	1	Qur'an	1
Islamic History	1	Islamic History	1
<i>Aqeeda</i>	2	<i>Aqeeda</i>	2
<i>Logic</i>	2	<i>Logic</i>	2
<i>Fiqh</i>	2	<i>Fiqh</i>	2
Arabic Conversation	5	Arabic Grammar	5
Grammar (Eng. Or French)	4	Arabic Conversation	1
Conversation (English or French)	2	Conversation (English or French)	<u>2</u> 20
Physical Training	<u>1</u> 20		
<b>Second Year</b>			
Tafseer	1	Tafseer	1
Islamic History	1	Islamic History	1
<i>Aqeeda</i>	2	<i>Aqeeda</i>	2
<i>Logic</i>	2	<i>Fiqh</i>	2
<i>Fiqh</i>	2	Arabic Grammar	5
Arabic Grammar	5	Arabic Conversation	1
Arabic Conversation	1	Grammar (English or French)	4
Grammar (Eng. Or French)	4	Conversation (English or French)	2
Conversation (English or French)	<u>2</u> 20	School of Philosophy	<u>2</u> 20
<b>Third Year</b>			
Tafseer	2	Tafseer	2
Islamic History	1	Islamic History	1
<i>Fiqh</i>	4	Usul Al- <i>Fiqh</i>	3
Arabic Grammar	3	<i>Fiqh</i>	3



Arabic Conversation	I	Arabic Grammar	3
Grammar (English or French)	2	Arabic Conversation	I
Principles of Economics	4	Grammar (English or French)	2
Mathematics for Economists - I	<u>3</u>	Mathematics for Economists - II	3
	20	Macro Economics	<u>3</u> 21
<b>Fourth Year</b>			
Usul Al-Fiqh	3	Usul Al-Fiqh	3
<i>Fiqh</i>	4	<i>Fiqh</i>	4
Arabic Conversation	1	Arabic Conversation	1
Maani wa Bi an	3	Maani wa Bi an	3
Grammar (English or French)	2	Grammar (English or French)	2
Micro Economics	3	History of Economic Thought	3
Statistics	<u>4</u> 20	Econometrics	<u>4</u> 20
<b>Fifth Year</b>			
<i>Fiqh</i>	4	<i>Fiqh</i>	4
Arabic Conversation	1	Arabic Conversation	1
Grammar (English or French)	2	Grammar (English or French)	2
Economic Planning	3	Economics of Iran	4
Growth and Development Economics	3	Socialist System of Economic Planning	2
Money and Banking	3	Economic Planning in Islamic Economics	3
Multinational Corporation	2	Research Report	<u>3</u> 19
International Economic Institutions	<u>2</u> 20		
Total Hours in 5 years = 40+40+41+40+39 =200			
Total Subjects in 5 years = 18+18+17+14+15 = 82			

## **Annexure 2**

### **CONTENTS OF THE TWO WEEK REFRESHER COURSE FOR TEACHERS OF ISLAMIC ECONOMICS**

#### **Nature of Islamic Economics**

1. Zarqa, A. "Islamic Economics: An Approach to Human Welfare", in SIE: 3-18.
2. Hasanuzzaman, S. Muhammad "Definition of Islamic Economics", J.R.I.E., 1(2), Winter 1984: 51-3.
3. Khan, Muhammad Akram "Islamic Economics: Nature and Need", J. R. I. E., 1(2) 1984: 55-61.
4. Kahf, M. "Islamic Economics and Its Methodology", in TIE: Chapter 1: 1-11
5. Ahmad, K. "Introduction", in SIE: xiii-xxiii.
6. Mawdudi, S. A. A. "Ma'ashi Qawaneen ki Tadween-a-Jadid aur Usky Usul", (Guidelines for Reconstruction of Economics from an Islamic Perspective) in MI: Chapter eleven, 417-36. (U).
7. Tasin, Muhammad "Islami Iqtisadiyat sey Muta'allaq Chand Usuli Baten", (Some Fundamental Issues in Understanding Islamic Economics) Fikr-o-Nazar, 14(2), August 1976: 81-101; 14(3), September/October 1976: 209-20. (U).
8. Mannan, Mohammad A. "Islamic Economics as a Social Science", J.R.I.E., 1(1), Summer 1983: 49-61.

#### **Muslim Economic Thinking**

1. Siddiqi, Muhammad Nejatullah "Muslim Economic Thinking: A Survey of Contemporary Literature", in SIE: 119-315.
2. - "Recent Works on History of Economic Thought in Islam: A Survey, ICRIE, Research Series in English, Paper No. 12, 1982, 60p.
3. Boulakia, J.D.C. "Ibn Khaldun: A Fourteenth Century Economist", Journal of Political Economy, 79(5), September/October 1971: 1105-18.

4. Zaim, S. "Contemporary Turkish Literature on Islamic Economics", in SIE: 316-50.

#### **Islamic Economic System / Economic System of Islamic**

1. Mawdudi, S.A.A. "Qur'an ki Ma'ashi Ta'limat", (Economic Teachings of the Qur'an) in MI: Chapter Two, 67-117. (U)
2. ----- "Islami Nizame Ma'ishat kay Usul aur Maqasid", (Principles and Objectives of Islamic Economic Order) in MI: Chapter Four, 141-63. (U)
3. ----- "Sarmayadari aur Islam ka Farq", (Difference between Capitalism and Islam) in MI: Chapter Three, 119-39. (U)
4. Qazi, A. G. N. "Economic System of Islam", (Speech delivered at National Defence College, Rawalpindi on 6th August 1983). Karachi. State Bank of Pakistan, 1983.
5. IKIN
6. Siddiqi, Muhammad Nejatullah, Some Aspects of Islamic Economy, Lahore: Islamic Publications Ltd., 1970.
7. -----, "Guarantee of Minimum Level of Living in an Islamic State". Paper read at ZICIE (See also comments on this paper by S. N. H. Naqvi at the conference).
8. -----, Islam ka Nazriyya-e-Milkiyyat (Ownership in Islam), 2 Volumes. Lahore: Islamic Publications Ltd., 1968. (U)
9. Chapra, Muhammad Umar, The Economic System of Islam, Karachi: University of Karachi, 1971.
10. -----, "The Islamic Welfare State and Its Role in the Economy", in SIE: 143-69.
11. -----, "Review on Ethics and Economics: An Islamic Synthesis", The Muslim World Book Review, 2(1), Autumn 1981. 21-6.
12. Naqvi, S.N.H., Ethics and Economics: An Islamic Synthesis. Leicester, U.K.: The Islamic Foundation, 1979.
13. -----, Individual Freedom, Social Welfare and Islamic Economic Order. Islamabad: Pakistan Institute of Development Economics, 1983.

14. Mirakhor, A., "Attempt to synthesize Islamic ethics and modern economics". Crescent International, 13(7), Ramadan 16 - Shawwal 1, 1404 (June 16-30, 1984): 9,11.
15. Ishaque, K. Muhammad "Private Property and Its Role in Islamic Social Order", in ESI: 19-54.
16. ----- The Islamic Approach to Economic Activity and Development", in MWFEQ: 74-100.
17. Sakr, Muhammad Ahmad "The Role of State in the Economic System of Islam", in INIEO, 103-16.
18. Ibn Taymiya, Public Duties in Islam: The Institution of the Hisba. Translated by Muhtar Holland: edited by K. Ahmad, Leicester, U.K.: The Islamic Foundation, 1982.
19. Khan, Muhammad Akram "Al-Hisba and the Islamic Economy", in Ibn Taymiya, op.cit.: 135-51.
20. Awan, A. A., Equality, Efficiency and Property Ownership in the Islamic Economic System, Lanham, MD: University Press of America, 1983.

#### **Microeconomic Theory of An Islamic Economy**

1. Seohari, Muhammad Hafiz-ur-Rahman, "Inferadi Ma-ishat", (Microeconomics) in IKIN: 61-7. (U).
2. Kelani, Abdul Rahman, -Islam mei Zabita-e-Tijarat (Islamic Code of Business Ethics). - Edited by A. Zubeidi and Abdul Wakeel Alvie. Lahore, Maktaba-tus-Salam, n.d. (U).
3. Mannan, Muhammad A. "Scarcity, Choice and Opportunity Cost: Their Dimensions in Islamic Perspective", ICRIE, Research Series in English, Paper No. 10, 1982.35p.
4. Reference Nos. 18 19 in III.

#### **Consumer Theory**

1. Ariff, Mohammad, "Towards Establishing the Micro foundations of Islamic Economics. A contribution to the Consumer Behavior in an Islamic Society". Paper presented at the 12th Annual Conference of the Association of Muslim Social Scientists, November 1983.29p.

2. Kahf, M. "The Theory of Consumption", in TIE: Chapter 11, 15-25.
  3. -----, "A Contribution to the Theory of Consumer Behavior in Islamic Economy", in SIE: 19-36.
- Theory of Firm
1. Siddiqi, Muhammad Nejatullah "Ends of Economic Enterprise", in EEI: Chapter One, 1-34.
  2. -----, "Justice and Benevolence as the Bases of Entrepreneurial Behavior", in EEI: Chapter Two, 35-73.
  3. -----, "Muslim Entrepreneur and the Economy", in EEI: 139-52.
  4. Kahf, M., "The Theory of Production", in TIE; Chapter III, 29-38.
  5. Metwally, Muhammad M. "A Behavioral Model of Islamic Firm". ICRIE, Research Series in English, Paper No. 5, n.d. 13p.

#### **Market Structure and Resource Allocation**

1. Reference No. 2 in IV. 1.
2. Siddiqi, Muhammad Nejatullah, "The Market Under the Influence of the Islamic Spirit", in EEI: Chapter Three, 75-138.
3. Kahf, M., "Market Structure: Free Cooperation", in TIE: Chapter IV, 41-56.
4. Mannan, Muhamman A., "Islamic Perspectives on Market Prices and Allocation", ICRIE, Research Series in English, Paper No. 5, 1982, 31p.
5. -----, "Allocative Efficiency, Decision and Welfare Criteria in an Interest-Free Islamic Economy. A Comparative Policy Approach", in MFEI: 43-73.
6. Reference Nos. 18 and 19 III.

#### **Basic Macroeconomic Themes in Islamic Economics**

1. Kahf, M.. "A Contribution to the Theory of Consumer Behavior in an Islamic Society", in SIE: 19-36
2. Khan, Muhammad Fahim, "Macro Consumption Function in an Islamic Framework", J.R.I.E., I (2), Winter 1984. 1-24.

### **Investment**

1. Kahf, M. "Saving and Investment Functions in a Two-Sector Islamic Economy", in MFEI: 107-23.  
Zarqa, Muhammad A., "An Islamic Perspective on the Economics of Discounting in Project Evaluation", in FPRAI; 203-52.
2. Choudhry, M. A., "The Rate of Capitalization in Valuation Models in an Islamic Economy", in FPRAI: 287-313.
3. Naqvi, S.N.H., "Interest Rate and Intertemporal Allocative Efficiency in an Islamic Economy", in MFEI: 75-106.

### **Money, Banking and Monetary Policy in an Islamic Economy**

1. Siddiqi, Muhammad Nejatullah, "Islamic Approach to Money, Banking and Monetary Policy" in MFEI: 25-42 or more recent version of the same in IIBSP. 15-50.
2. Ariff, Mohammad "Introduction", in MFEI: 1-23.
3. Ahmad, Z., Iqbal, M. and Khan, Mohammad Fahim, "Introduction", in MBI: 1-25

### **Nature of Money and Interest: The Western View and the Islamic Viewpoint**

1. Saud, M. A., "Money, Interest and Qirad", in SIE: 59-84.
2. Ahmad, Z. "The Theory of *Riba*," Islamic Studies, 17(4), Winter 1978: 171-85. (Reprinted from Islamic Quarterly, January/June 1978).
3. Shafi', Mufti Muhammad Masa'ala-e-Sud (The Problem of Interest). Karachi: Dar al-Asha'at, 1979. (U).
4. Ahmad, M. "Semantics of Theory of Interest", Islamic Studies, 6(2), June 1967: 171-96.

### **Alternatives to Interest in an Islamic Economy**

1. Council of Islamic Ideology "Report on the Elimination of Interest from the Economy", (along with "Interim Report of the Panel of Economists and Bankers on the Elimination of Interest") in MBI: 103-257.

2. Ali, M. "Mudarabat and Shirakat as a Basis of Interest-Free Economy", in IFBP: 127-41.
3. Siddiqi, Muhammad Nejatullah, *Shirkat aur Mudarabat kay Shar'i Usul* (Principles of Shirakah and *Mudarabah* in *Shari'ah*). Lahore. Islamic Publications Ltd., 1969 (U)
4. -----, "Business of the Bank", in BWI: Chapter 2, 19-38.
5. -----, "The Bank and The Owners of Capital",  
  
in BWI: Chapter 3, 39-52.
6. -----, "Banking in an Islamic Framework", in IIBSP: 51-65.
7. -----Rationale of Islamic Banking", in IIBSP: 67-96.
8. -----, "The Process of Credit Creation", in BWI: Chapter 5, 73-96.
9. - -----, "Monetary Theory of Islamic Economics", in IIBSP: 125-31.
10. -----, "Some Clarification", in BWI: Chapter 9, 167-76.
11. - -----, --Economics of Profit-Sharing", in FPRAI; 163-201.  
  
(See also IIBSP: 97-123).
12. - -----, " Banking in an Islamic Framework", in MWFEQ: 101-11.
13. Ahmad, Z. "Inaugural Address", in IFBP: 3-18.
14. Chapra, Muhammad Umar, "Money and Banking in an Islamic Economy", in MFEI: 145-86.
15. Mohsin, Mohammad "A Profile of *Riba-Free* Banking, in MFEI: 187-210.
16. Uzair, Muhammad, "Some Conceptual and Practical Aspects of Interest-Free Banking", in SIE: 37-57.
17. Bashir, B. Ahmad "Successful Development of Islamic Banks", J.R.I.E. 1(2) Winter ±984: 63-71

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5. -----, "The Relative Efficiency of Interest-Free Monetary Economics: The Fiat Money Case", in SIE: 85-118.
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7. Chapra, Muhammad Umar, "Monetary Policy in an Islamic Economy", in MBI: 27-68.
8. Khan, Muhammad Akram, "Inflation and the Islamic Economy. A Closed Economy Model", in MFEI: 237-68.
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3. Kahf, M. "Taxation Policy in an Islamic Economy" in FPRAI: 131-61.
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#### **Organization of Economic Activity in Islam**

1. Masud, H. Muhammad, "Islamic Land Tenure System", Islamabad: International Institute of Islamic Economics (Forthcoming).
2. Reference Nos. 2 in IV.1 and 2 and 3 in VI.3

#### **Islam and New International Economic Order**

1. Ahmad, K. "A Muslim Response", in J. Gremillion and W. Ryand (eds.) World faiths and the New World Order, Washington, D.C.: Inter-Religion Peace Colloquium, 1978: 171-93.
2. MWFEQ.

#### **Organization of Economic Activity in Islam**

1. Masud, H. Muhammad "Islamic Land Tenure System", Islamabad: International Institute of Islamic Economics, Forthcoming).
2. Reference Nos. 2 in IV.1 and 2 and 3 in VI.3

#### **Islam and New International Economic Order**

1. Ahmad, K. "A Muslim Response", in J. Gremillion and W. Rayan (eds.) World faiths and the New World Order, Washington, D.C.: Inter-Religion Peace Colloquium, 1978: 171-93.
2. MWFEQ

## A GLOSSARY OF ABBREVIATIONS USED

1.     **BWI**             Siddiqi; Muhammad Nejatullah, Banking Without Interest, Leicester, U. K.: The Islamic Foundation, 1983 (Also Volker Neinhause's Review in J.R.I.E., 1(2), Winter 1984: 84-93.
2.     **EEI**             Siddiqi, Muhammad Nejatullah, The Economic Enterprise in Islam, Lahore, Islamic Publication Ltd., 1979.
3.     **ESI**             Economic System of Islam (Proceedings of a seminar organized by The National Bank of Pakistan in April 1979). Karachi: The National Bank of Pakistan, 1980.
4.     **FPRAI**          Ahmad, Z. Iqbal, M. and Khan, Muhammad Fahim (eds.) Fiscal Policy and Resource Allocation in Islam. Islamabad: Institute of Policy Studies, 1983..
5.     **ICRIE**          International Center for Research in Islamic Economics, King Abdulaziz University, Jeddah, Saudi Arabia.
6.     **IFBP**          Interest-Free Banking in Pakistan (Proceedings of the Seminar on "Islamization of Banking" held in 1980), Karachi. The Institute of Bankers in Pakistan, n.d.
7.     **IIBSP**          Siddiqi, Muhammad Nejatullah, Issues in Islamic Banking, Selected papers, Leicester, U.K.: The Islamic Foundation, 1983 (Also Muhammad A: Mannan's Review in J.R.I.E: 1(2), Summer 1983, 69-72.
8.     **IKIN**          Seoharwi, Muhammad Hafiz-ur-Rehman, Islam ka Iqtisadi Nizam (Economic System of Islam), Lahore. Adara-e-Islamiyat, 1981 (U)
9.     **INIEO**          Islam and a New International Economic Order: The Social Dimension (Proceedings of the symposium held on the same theme, in Geneva, 7-10 January, 1980), Geneva, International Institute for Labor Studies, 1980.
10.    **JRIE**          Journal of Research in Islamic Economics.

11.       **MBI**        Ahmad, Z., Iqbal, M. and Khan, Muhammad Fahim (eds.) Money and Banking in Islam, Islamabad: Institute of Policy Studies, 1983.
12.       **MFEI**        Ariff, Mohammad (ed.) Monetary and Fiscal Economics of Islam, Jeddah: International Center for Research in Islamic Economics, 1982.
13.       **MI**        Mawdudi, S.A.A., Ma'ashiyat-e-Islam (Economics of Islam), edited by K. Ahmad. Lahore: Islamic Publications Ltd., 1969 (U)
14.       **MWFEO**        The Muslim World and the Future Economic Order (Proceedings of the Conference held, on the same theme, in London during July 4-9, 1977). London: Islamic Council of Europe, 1979.
15.       **SIE**        Ahmad, K. (ed.) Studies in Islamic Economics, Leicester, U.K.: The Islamic Foundations, 1980.
16.       **TIE**        Kahf, M., The Islamic Economy: An Analytical Study of the Functioning of the Islamic Economic System, Plainfield, Indiana: The Muslim Students' Association of the United States and Canada, n.d. (Also Muhammad Umer Chapra's Review in J.R.I.E. 1(2), Winter 1984: 83-5.
17.       **(U)**        The title is in Urdu.
18.       **2ICIE**        The Second International Conference on Islamic Economics held during March 19-23, 1983 at the Islamic University, Islamabad.

### Annexure 3

#### LIST OF TOPICS COVERED IN SENIOR OFFICERS TRAINING PROGRAM IN ISLAMIC ECONOMICS DOCTRINES AND THEIR PRACTICAL APPLICATION CONDUCTED BY IRIE

S1.	Topics	Remarks
1.	Main Components of the Universal Islamic Message	
2.	Islamic Approach Towards Life	
3.	Ejaz ul Qur'an	
4.	Introduction to Hadith Literature	
5.	Economics of Qur'an	
6.	The Concept of <i>Al Adl Wal Ihsan</i>	
7.	Maqasid <i>Al-Shari'ah</i>	
8.	Ideological Basis for Pakistan Movement	
9.	The Applicability of Islamic <i>Shari'ah</i> in the Context of Modern World Conditions	
10.	Extension Lecture on "Concept of Credit and its [Evening Lecture] Application in Modern World"	
11.	History of Islamic Economics Thought	
12.	Contribution of Islam to World Civilization	
13.	Economic System of Islam	
14.	Islamic Economic System	
15.	Islamic Viewpoint on Distribution of Income and Wealth	
16.	Islam's Distribution System	
17.	Concept of Ownership and Property Relationships in Islam	
18.	The Prophet (Pbuh) ka Moa'ashi Inqila'ab	
19.	Land Tenure System and Land Reforms in an Islamic State	

20. Work-Employer Relationships in Islam
21. "Source of Islamic Law"
22. Social Justice in Islam
23. *Riba* in the light of Qur'an and *Sunnah*
24. Economic Rationale of the Prohibition of Interest and Virtues of an Interest-Free Economy
25. Seminar on "Business Practices in Islamic *Shari'ah*"
26. Islamization of Commercial Banking in Pakistan
27. Role of *Ijtehad* in Meeting the Challenges of Modern World
28. Worker-employer Relationships in Islam
29. Commercial Banking Based on Islamic Principles
30. Elimination of Interest from Government Transactions (including Islamic Viewpoint on Deficit Financing)
31. General Discussion
32. "The Present State of Islamic Finance Movement" [Evening Lecture]
33. Resource Allocation and Project Evaluation in an Islamic Economy
34. Principles of Public Expenditure in an Islamic Economy
35. System of *Zakah* and *Ushr* in Operation in Pakistan: A Description
36. Some Misgivings about Islamic Interest-Free Banking
37. Islam and Insurance
38. Central Banking and Monetary Policy in an Islamic Economy



- 39. Recommendations of the Council of Islamic Ideology on Economic Issues
- 40. Extension Lecture on "Islamization of Commercial Banking in Pakistan" [Evening Lecture]
- 41. Development Finance Institutions and Instruments in an Islamic Economy
- 42. Taxation, PLS System and Islamization
- 43. Islamic Theory of Public Finance and Principles of Taxation in an Islamic Economy
- 44. Role of Awqaf
- 45. "Islamization Process in Pakistan" [Evening Lecture]

## **CONCLUSION**

In this paper we have described the major teaching/training programs in Islamic economics, provide some comparative assessment and most importantly identified some of the areas where improvements in the existing programs are needed. Attempt has also been made to identify areas where new programs are required to meet pressing needs. Some suggestions have been made only to initiate the discussion.

## Annexure I-A

### CURRICULUM FOR THE B. SC. (HONS) DEGREE AT IIIE, IIU, ISLAMABAD

I-Term		II-Term	
Course Title	Nos. of Credits	Course Title	No of Credits
<b>First Year</b>			
Arabic (Reading) I	4.5	Arabic (Listening Practice	4.5
Arabic Grammar I	4.5	Arabic Grammar II	4.5
Arabic (Conversation and Composition)	4.5	Arabic (Conversation and Composition)	4.5
Islamic Studies Arabic I	4.5	Islamic Studies Arabic II	4.5
English (Reading) I	3	English (Reading) II	3
English Grammar I	3	English Grammar II	3
English (Composition) I	3	English (Composition) II	3
	27		27
<b>Second Year</b>			
Arabic III	4.5	Arabic IV	4.5
English III	4.5	English IV	4.5
Introduction to Economic Theo I	4.5	Introduction to Economic Theo II	4.5
Mathematics for Economics	4.5	Mathematics for Economics II	4.5
Usul Al-Fiqh (I)	3	Fiqh al-Muamilat ul-Maliyya I	3
Pakistan Studies	3	Economic Doctrines of Islam	3
The Islamic Man	3	The Islamic System	3
	27		27
<b>Third Year</b>			
Micro-Economics I	4.5	Micro-Economics II	4.5
Macro-Economics I	4.5	Macro-Economics II	4.5
Monetary Theory	4.5	Public Finance	4.5
Introductory Statistics	4.5	Basic Econometrics	4.5
Usul Al-Fiqh II	3	Usul Al-Fiqh III	3
Fiqh Al-Muamilat Al-Maliyya II	3	Fiqh Al-Muamilat Al-Maliyya III	3
Arabic	3	Arabic	3
	27		27
<b>Fourth Year</b>			
Advanced Micro-Economics	4.5	Advanced Macro-Economics	4.5
Comparative Economic System	4.5	Economic Development	4.5

Readings in Islamic Economics	4.5	Economics of Muslim Countries*	3
International Trade and Finance	4.5	Current Issues in Islamic Economics	4.5
History of Economic Thought	3	Readings in Economic System of Islam	4.5
Research Methods for Social Scientists	3	Research Project * *	3
Usul al-Fiqh IV	$\frac{3}{27}$	<i>Fiqh</i> al-Muamalat IV	$\frac{3}{27}$
<p>* Alternatively: "The Pakistan Economy"</p> <p>** Alternatively: "Project Evaluation"</p> <p>Total credits in 4 years: <math>54+54+54+54 = 216</math></p> <p>Total subjects in 4 ears: <math>14+14+14+14 = 56</math></p>			

**Annexure 1-B**

**CURRICULUM FOR THE B. A. DEGREE IN  
KULLIYAH OF ECONOMICS INTERNATIONAL  
ISLAMIC UNIVERSITY, MALAYSIA**

I-Term		II-Term	
Course Title	No. of Credits	Course Title	No. of Credits
<b>First Year</b>			
Economics I	3	Economics II	3
Quantitative Analysis I	4	Quantitative Analysis II	4
Introduction to Business Administration	3	Introduction to Accounting	3
Introduction to Islam and its Aqidah	2	Introduction to Al-Qur'an	2
Elementary Qur'anic Language-I	2	Elementary Qur'anic Language-II	2
Elementary English Language-I	2	Elementary English Language-II	2
	I6		I6
<b>Second Year</b>			
Microeconomics	4	Macroeconomics	4
<i>Fiqh of Economics I</i>	3	<i>Fiqh of Economics II</i>	3
Introduction to Computers and Information Processing	3	Introduction to Development and Planning	3
Introduction to Al-Sunnah	2	<i>Fiqh Al-Ibadat</i>	2
Introduction to Al-Shari'ah	2	Intermediate Qur'an Language-II	2
Intermediate Qur'anic Language I	2	Intermediate English II	2
Intermediate English I	2		I6
	I8		
<b>Third Year</b>			
Economic Analysis I	4	History of Islamic Economic Thought	3
Monetary Economics	3	Fiscal Economics	3
Economics of Welfare and Distribution	3	International Economics	3
Econometrics I	4	Economic Analysis II	3
<u>Ethical Philosophy of Islam</u>	2	<u>Research Methodology</u>	3
The Preaching of Islam	2	Islamic Civilization	2
	I8		I7

<b>Fourth Year</b>			
History of Western Economic Thought	3	Regional Cooperation among Muslim Countries	3
Comparative Economic Systems	3	Project Evaluation	3
Project paper and anyone or two of the following elective courses listed below:	2	Project paper and anyone or two of the following elective courses listed below:	4
<u>Development Studies</u>		<u>Development Studies</u>	
Economic Planning	3	Econometrics II	3
Development Finance	3	International Trade and Development	3
Comparative Development Experience	3	Development Administration	3
International Studies		Regional Economics	3

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## DISCUSSION

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Opening notes by Dr. Munawar Iqbal

*Bismi Allah al Rahman al Rahim*

Mr. Chairman and Dear Colleagues.

First of all I would like to thank the Mr. Chairman for the kind words that he has spoken about me while introducing me. It is a great pleasure for me to speak to such a distinguished gathering. Most of my colleagues around the table here have spent their life teaching. Therefore, I feel privileged to talk on a subject which most of you have spent a lifetime in practicing. I feel that during the discussion session, I will bet very important and useful feedback from my colleagues around the table. I myself have spent a considerable part of my career teaching Islamic economics at the International Institute of Islamic Economics, International Islamic University, Islamabad which has both undergraduate and graduate programs including Ph.D. program in Islamic economics.

Before I go to the core of the Subject, I would like to make a couple of points which are well known to you, but which it is important to put on the record in any discussion of the teaching of Islam or various branches of Islam, Islamic economics being one of those. The first important thing which we have to keep in mind, as teachers, is that, in Islam, education is an *Ibadah*. Islam emphasizes the seeking of knowledge to such an extent that it makes it a *Faridah* (obligation) on each Muslim male as well as female.

The second important observation is that Islam has an edge, I would say, over many other system in its access to a very distinct source of knowledge which we call revelation. if we talk about various sources of knowledge, in general, humanity depends on human experience, i.e., the sources of knowledge whether we seek them through research, through our own thinking or through observation. All of these methods or sources utilize our own intellect. They are open to all humanity and they are one of the most important sources of knowledge common to all humanity, Muslims as well as non-Muslims.

Islam gives the prime position, as far as sources of knowledge are concerned, to Revelation, which is that knowledge we believe to be perfect and universally applicable. The second sources of knowledge, which as I mentioned we acquire through various methods, comes next to that prime knowledge which we consider to be perfect, unalterable and applicable to all places as well as to all science. Therefore, have to approach the teaching of any Islamic discipline, Islamic economics included, in this perspective.

*Allah Subhanahu wa Ta'ala*, as a grace to humanity, as *a'Rahm'* to humanity, has revealed certain facts through his . messengers, which have a bearing on our life and which are the pillars or the foundations on which we then have to build the further acquisition of knowledge through our efforts.

Islam encourages Muslims to seek knowledge through all possible means and in order to seek that knowledge we may benefit even from non-Muslims. This particularly applies in the field of economics, which is a science that was developed in the West. As far as Islamic economics is concerned, it is an infant science, a science which has had a very short life. As you are aware its beginnings were mostly in the Department of Religion, Department of *Shari'ah* and, sometimes, in some countries, Islamic economics started as one of the subjects at the M.A. level. For examples, in Pakistan, there is only one course among eight courses called Economic Values of Islam. Otherwise, in most Muslim countries, Islamic Economics is a part of the Faculty of *Shari'ah*

When we started the program in Islamabad, we discussed it thoroughly. What we meant by. Islamic economics was not merely one or two courses in .*Fiqh* attached as an appendix to a list of courses being taught in secular programs of Islamic economics. We wanted to have a comprehensive approach to the teaching of Islamic economics.

To us, Islamic economics our brand of the teaching of economics, as other secular universities teach it. However, our distinct approach was that the same. problems, the same issues which those people study from their perspective, we have to study from our perspective. In this regard, if we have to study from another perspective, we have to provide our students with that perspective. This is a very challenging task for any person who is designing a program in Islamic economics or who is practically involved in the teaching of Islamic economics.



Unfortunately in most Muslim countries, education has been divided into so-called modern education and Islamic or *Madrassa* education. In most Muslim countries, Arab as well as non-Arab countries, so-called modern education goes through entirely different channels and there is no interaction between these two channels.

A teacher who has to prepare a course for his graduate students in Islamic economics, has a number of problems. The first one is the medium of instruction. *Madrassa* education is usually conducted in Arabic or in the local language, which so-called modern education is in either the local language or in English. If we are going to prepare a course, we must combine these two? which is the first objective. As I mentioned a few minutes ago, the basic objective of the teaching of Islamic economics is to merge these two systems. We have to create a person who is well versed in economic tools and analysis and has sufficient knowledge of Islam and its various branches.

In order to evaluate that knowledge critically, examination and modification are necessary as well as the reconstruction of economic theory in the perspective of Islam. Another important consideration in designing and teaching these courses is the unfortunate fact that in most Muslim countries *Madrassa* education is less developed than modern education and it provides odd job opportunities in some of Ministries of Religious Affairs and something like that. People who have a specialty in various branches of religious education are not given proper status in the job market. This is another practical consideration, and because of this, in teaching Islamic economics, we have to prepare students in such a way that after they receive their education, they have enough knowledge to do enough theoretical work that gives them good employment opportunities, and at the same time, be able to reconstruct economic theory in the light of Islam. We have to be practical, and pragmatic in our approach while doing this. We have to prepare them for the market job by giving them the kind of knowledge and subjects which are acceptable in the market. These, therefore, are some of the difficulties which we have to keep in mind while teaching Islamic economics at the university level.

One of my papers is being circulated although my lecture today is not entirely based on that paper. Mondal asked, last night if there is supplementary reading which can be helpful for the participants of this seminars, and perhaps this paper may provide some useful information.

One of the things which I have tried to accomplish in the paper is to compare three major programs which are currently in effect in the field of Islamic economics: one at the International University at Islamabad; the second at the International Islamic University, Malaysia and the third, I must say, University in Iran. (A paper was circulated among the participants regarding teaching programs).

### **Question**

How can we reconcile Islam and economics from the point of view that we cannot conceive matter without idea or spirit without matter? How can we reconcile these two from an Islamic perspective ?

### **Munawar Iqbal**

I think that Islam deals with real problems; Islam is a very practical religion. As I mentioned, revealed knowledge is only a very small part of the stock of human knowledge. Most knowledge is acquired through human efforts, which efforts we are encouraged to make. The only problem which a human being, whether Muslim or non-Muslim faces, the question of approach. We approach the problem in a different way than the secular economists do.

Let me give you an example related to one of the themes of secular economics, which deals with the study of limited resources and unlimited wants. I believe that in Islam we have a different approach to the problem of scarcity from what many of you have studied in your textbooks which say that the problem of scarcity arises because of the niggardliness of nature. Resources are limited, wants are unlimited. There is not enough to go around. Nature, has been niggardly or miserly and that gets right to the problem of scarcity. We believe that is not ethical. Allah (*Subhanahu wa Ta'ala*) has declared in the Qur'an that there is no difficulty for human beings, not a single creature in the universe whose sustenance has not been guaranteed and provided for by Allah (*Subhanahu wa Ta'ala*)". Resource in that sense, are not limited. This is opposite to what secular economists believe, there is enough to go.

On the demand side, we also believe that the wants are not unlimited. We are not interested in fulfilling each want of every human being. We are here to fulfill the objectives of the Islamic economic system which is to fulfill human needs, not wants. Need does not only mean sustenance. It also includes

convenience, comforts, etc. However, there is no kind of consumer sovereignty saying that you can do whatever you like. There are limits that you can go to.

Therefore, in Islam at a particular point in time, there may be a problem of scarcity. However, that problem of scarcity does not arise because of the niggardliness of nature. It arises either because of the lack of effort on the part of human beings, the mismanagement of resources or the mismanagement of their wants. They have to control their wants. Islam approaches the economic problem from both the supply and as well as the demand side. You have to curb your demand, so to speak, and you have to make efforts to increase your resources. In this way, you solve the economic problem. The economic problem is the human problem, and Islam approaches the human problem in a different manner.

#### **K. T. Hussain**

Munawar Iqbal's paper, it should be mentioned, is the type of paper that we need for this seminar, and I think that more time should be devoted to this subject than only one session. Iqbal has already demonstrated a missionary zeal for promoting the study of Islamic economics, and in the course of his lecture he seemed to suggest that epistemology should also be incorporated in the teaching of economics. Now, I do not know how far that can be accommodated. Moreover, the *Shari'ah* materials that he recommends are usually taught before the entry of the student to the university. So, it seems to me that those who are already familiar with those materials should not have to study them again.

For example, in Bangladesh, the *Madrasa* students already know most of this material, in which case perhaps it could be replaced to advantage by more advanced materials in economics and by quantitative materials used by students of economics including courses on computer, etc. Iqbal also mentioned in the course of presentation that Islamic economics courses are offered in different places only in English language. I think it would be an advantage if other modern languages e.g., Japanese, French, German, etc., were also included. In addition to English, and Arabic should also be declared a medium of instruction in different courses.

How useful it is to expose young people to this kind of training depends on whether this kind of training can be utilized in the national economy. The national economy must be geared to the utilization of this kind of training, otherwise, it would be just like exposing a student to something like Greek

mythology or poetry. It must have applicability. We must insure that; otherwise, it will be a waste of time for our students. Whether the national government and economy are geared to utilizing people who are trained in this line should also be considered. Thank you.

### **Munawar Iqbal**

There are several important questions that have been raised, and there are at least two points which I would like to make. One is the question of the *Shari'ah* and economics. A student coming from a *Madrassa* education has already taken *Shari'ah* subjects, and I agree that he should not be given more *Shari'ah* subjects. The scheme that I have suggested is only one proposal, i.e., it is only one model of the subject. I endorse the view that there should be more discussion on this particular subject. However, I agree that students coming from a *Madrassa* education should not be given more *Shari'ah* courses.

As we mentioned, we need at least two types of people. One type is those who are experts in the *Shari'ah* with sufficient background in economics. Those who have studied *Shari'ah* subjects belong to that particular group. We want to give them a further knowledge in the *Shari'ah* and at the same time give them the necessary knowledge in economics so that they can appreciate modern problems and economics. In order to accommodate this, I have proposed that we keep the major in *Fiqh*, so that they will take more courses in *Fiqh* and less courses in economics.

The second type of students that we need are those coming from a college education who will take only a few courses in *Fiqh*. We will try to direct them more towards economics because they have a comparative advantage in that particular area. Therefore, we will give them more courses in economics, so that they can take a major in economics. However, we will give them the minimum required courses in the *Shari'ah*, which I proposed in this particular structure. If there are people who have the ability to do a double major, there is also a provision for that.

The second question, which is also important, is the issue of language. Should a local language be added in addition to English and Arabic ? English and Arabic, in my view, seem to be indispensable in the teaching of Islamic economics. We have to give students both of these languages because of the nature of the subject matter. As far as the local language is concerned, I personally feel that at the graduate level, it may not be required. We know from

our experience that students learn languages whether we teach them or not. They learn a language to the extent that it is required. If a student wants to become a specialist in a certain language (for example, he wants to do it an M.A. in Bengali) he is free to do that. If he wants to do an M.A. in Urdu, he may pursue that language. However, in order to become an M.A. in economics, or a specialist in Islamic economics, he need not know Urdu and Bengali beyond the level which he has already achieved. Therefore, in order to keep the size of the program manageable, I think that local languages may not be required.

### **Faruq's Question**

As far as the first programs are concerned, I would like to add something more about the teachers who will teach Islamic economics. I think this is a very complicated problem nowadays. Suppose I am a teacher of economics. I have learned economics in English and micro-and macroeconomics are my specialties. However, I have not gone through Islamic *Shari'ah*, *Fiqh*, etc. My knowledge of these areas is meager.

Now what will happen when Islamic economics is introduced in my college or university ? Shall I have to teach Islamic economics? Are the *Madrasa* teachers experienced in Islamic economics, *Shari'ah*, *Fiqh*, etc.? Will they teach economics or will teachers like ourselves teach Islamic economics? If we are to teach Islamic economics at this level, we should have the opportunity to learn newly the *Shari'ah*, etc., so that we can teach Islamic economics properly. I think that this is a problem expressed by all the teachers assembled here. I think the speaker, Munawar Iqbal, will be able to answer this.

### **Munawar Iqbal**

I answered this question in my lecture, but this gives me an opportunity to reemphasize this issue because this is perhaps the most critical part in teaching Islamic economics. Most of us, myself included, in our formal education, did not have the opportunity of learning the proper combination of subjects needed by a teacher of Islamic economics.

Therefore, there are only two possibilities: either we embark upon a program of private study or we go back to school again. Now, going to school again is a problem at this stage of life. What I suggested in my paper is that there should be a one-year diploma course for graduates of economics who will study the relevant *Shari'ah* subjects. That will give them at least the beginning

of the kind of knowledge required to be a teacher of Islamic economics. Then they can build upon this either through private study or by taking another advanced diploma. This is the way in which, I think, we can solve this problem over the long term.

**Question: Engineer Muslihuddin**

Is there any scope for the study of Islamic economics at the university level by those who have neither a background in the *Shari'ah* nor in economics?

**Munawar Iqbal**

Of course, the seeking of knowledge is open to all and this does not only apply to Islamic economics. If somebody is a specialist in the *Shari'ah* and would like to study medicine, he is always welcome to do so. However, there are certain minimum requirements at the university level. You cannot start at the university level if you do not have a minimum knowledge in the discipline required. However, I do want to emphasize that engineers are not very far removed from economists. One of my colleagues when I was doing my Ph.D. had a Ph.D. in physics and was doing a Ph.D. in economics, and his performance was much better than many of those who were graduates in economics. Therefore, if you have the will and the time and perhaps the money as well, you can pursue your studies at any time.

**Ahmed Al-Hadi Siraj**

First of all, I feel the paper presented by Munawar Iqbal is very important and opens the door to many considerations and questions. I believe merely presenting economics topics along with *Shari'ah* topics will result in a problem for the student.

We must pay more attention to evolving a sort of integrated course which will help the student to learn the best in the *Shari'ah* as well as the best in economics. Otherwise, the teacher will merely be throwing information at the student who will pay the price for our inability to give him the right integrated thing. In other words, we must not give the student information in economics and information in the *Shari'ah* and ask him to do the job before us.

Secondly, I would like to emphasize that the teaching of Islamic economics in certain parts of the Muslim world has been going on for some time. Has there been any effort made to evaluate this experience in order to consider what steps we can take in the future ? I believe that now is the right time to make such an evaluation of our past experience in order to be prepared for taking wider steps in the future.

Again, I would like to emphasize the need for books which may be used as teaching and reading material for the students. Up to now, not enough efforts have been made in this direction.

I believe that the only way to do this is to have people from both fields (*Shari'ah* and economics) sit together and try to understand the language and the difficulties of each other.

I am not eager to take the part of defending the theory of Islamic law, but I will do so again with reference to the observation made by our brother, Munawar Iqbal, about the tendency prevailing among scholars of Islamic law to pay more attention to the level of the contract while deciding whether it is *Halal* or *Haram*. Well, as we were taught at an early age, the methodology of Islamic law is to consider not the level of any contract, but the content of the contract. A *Shari'ah* specialist must pay more attention to the contents of the contract, not to the appearance of the language used in the terms of the contract and in setting the conditions of the contract. I thank you again, and I am really grateful to the organizers of this seminar. Thank you, very much.

### **Munawar Iqbal**

Siraj has made a number of important observations, but he has not asked any question. He has made a number of comments, and I agree with him on most of those comments. I fully agree that there is an urgent need for developing integrated courses whereby the teacher of *Fiqh* can teach the students of economics. Siraj is aware of this because when we were colleagues, I as the director of the Department of Economics, wished to request the teachers of *Fiqh* through him to teach economics students.. Unfortunately, the *Fiqh* teachers were unable to comply because they did not have a background in economics. I would have liked a person who was a teacher of *Fiqh-al-Mu'amalat*, to teach the *Fiqh* of economics. This would have solved the problem that Siraj has raised. If the teacher is not doing that, then the burden, as he has rightly pointed out, is passed on to the students. If the teacher while teaching a course in *Fiqh-al-Mu'amalat*

could use the practical example of an Islamic bank, a contract of leasing, etc., he could solve the problems of the students.

Unfortunately, at the present time that is not possible for the reason, as I mentioned before, that *Shari'ah* experts do not have a proper knowledge of *Fiqh* in modern economics. This will happen when have people who can integrate the *Shari'ah* and economics. At present we are living through an ad hoc stage, and I do emphasize that Islamic economics is still an infant science. In the history of sciences, fifteen years is nothing. The development of science takes over a century. The science of economics was developed more than two hundred years, after the first writings in the field of economics. So fifteen years represents the infancy of Islamic economics.

**Question: Sulaiman Mondal**

In this country, students as well as teachers have a comparative disadvantage in learning Islamic economics. This is because most of the literature available is either in English or in Arabic, or in Urdu in this part of the country. So I would ask you, whether you have any proposal as to how to overcome this comparative disadvantage amongst teachers, students; and researchers in this country in studying, teaching and carrying out research in Islamic economics?

**Munawar Iqbal**

There are two things which you have to do and which many other countries also have to do. It is correct that most of the literature on Islamic economics is either in English or in Arabic. Of course, there is a lot of literature in another languages, e.g., Turkish, Persian, Urdu, Bengali, etc. However, a very large proportion of the literature available is in these two languages.

Therefore, there are two things that we can do. One possibility is that the literature could be translated into Bengali if the educational system prefers to continue with Bengali as the medium of instruction. The other possibility is that the medium of instruction should be either English or Arabic. In Pakistan at the university level, the medium of instruction is Urdu. Economics, for example, in most universities, except two (Quad-e-Azam University and the Islamic University in Islamabad), is taught in different languages, such as, Sindhi, Urdu and others. Regarding the teaching of Islamic economics at the



university level, from my point of view, the preferred model would be to use English and Arabic as the medium of instruction.

At the International Islamic University in Pakistan, we started the program at the undergraduate level, i.e., higher secondary school. That gives more time to teach students English and Arabic before they reach the M. A. level. However, in the short run, you may have to translate the literature into Bengali.

**Comment: K. T. Hussain**

I do not think that it is correct to state that in Bengali we do not have enough literature about Islamic economics. The literature contains more than a hundred titles of a good standard. Recently, the Islamic Foundation of Bangladesh published a two-volume book, entitled, "Economics in the Qur'an". We have undertaken research in this subject in the six years since the publication of this book. There are, in addition, many books in Bengali on the subject of Islamic economics and its various aspects. Our Chairman, Shah Mohammed Habibur Rahman, himself wrote such a book.

**M. Zuhurul Islam**

I am very grateful to Br. Munawar Iqbal for his presentation. I wonder whether it is possible to expand the foundation course for students entering universities to include not only Islamic economics, but also all the social sciences within Islamic dimensions. Indeed, a Social Science Institute could be established for orienting students as well as teachers to the study of Islamic economics in a non-Islamic environment.

My second question concerns the fact that students who graduate from the university in Islamic economics do not have enough job opportunities. What can be done about this ?

**Munawar Iqbal**

Let me start with the last question. I agree with all the comments made so far. The job situation is very, very important and I did not mention in my speech that while designing a course in Islamic economics, we as teachers have to keep in mind that we are not only training manpower but we also have to ensure that there are jobs for them in the marketplace.

Therefore, there is a need for courses in computer and other new technology similar to those that we have designed for the Islamic University, Islamabad. We have included courses on accounting in the degree program of economics because the market situation is better for those who have a degree in accounting. Masters degree holders in economic can either become teachers at the university or work in the ministries of economy, finance and trade. So we give them a specialty in economics. Today's market needs require that we diversify our approach.

As far as the job situation of graduates of the university is concerned, the first two or three groups of graduates from our program were able to find good jobs. We have a system of collecting impressions from employers, and I am pleased to report that the employers were satisfied with our graduates. The response that we got, Alhamdulillah, was very good. However, for the last two years, the situation has been very bad and the reason for that is not because of the graduates of the program. The reason is that these students have graduated at a time when there is a general depression in Pakistan.

On the other hand, I think that there is a tremendous need for specialists in Islamic economics in the Middle East. If graduates have the proper grounding in their field, they will find a job. I am confident that in the long run the job situation for graduates from courses of Islamic economics and banking is very good.

**Question: Abdul Awal Sarkar**

If we merge the modern education system with the Islamic education system, then the main problem of education might be overcome successfully? Do you agree?

**Munawar Iqbal**

There cannot be any doubt about what I mentioned regarding the difficulties of our education system. Our difficulty is that we have two different streams. Islam has a unified approach towards knowledge. So Islamic knowledge is one unity and there are various aspects of it. Let me give you a very simple example. The human body is one organic unit and in that organic unit there is a digestive system, a system of blood circulation, a nerve system, etc. There are doctors who specialized in the eyes, lungs, brain, etc., but all of them have to have a basic knowledge of human anatomy. Therefore, just as the

human body is one unit with various systems working within that unit in harmony with each other, there are various Islamic disciplines, which must take the same **approach**. There are, various specialties and Islamic economics is one of those specialties along with Islamic psychology and other disciplines.

### **Question: Abu Ahmad of Dhaka University**

Ten years ago there was a psychological problem in accepting Islamic economics as a discipline of study in the department of economics at the university. Now the psychology is positive to some extent and there is not nearly as much opposition as there was ten years ago. Now I would like to raise with this conference the problem that I find with the structuring of courses. For example, the Vice Chancellor of the Islamic University told us that there is no Islamic economics even in the Department of Economics at the Islamic University. Why is this so ? When we ask, we are usually told that they want such courses taught but that they do not know how to structure them or what type of content there should be or what types of books should be used. Also at the Islamic Studies Department at Dhaka University all are in favor of economics being taught there from the point of view of Islam, but, unfortunately, they do not have the appropriate course design or syllabus for structuring courses.

Therefore, I request that the appropriate expertise be made available to the relevant departments at the Islamic University, such as, Islamic Studies Department, the *Fikh* Department, the *Shari'ah* Department, Finance Department and the Management Department, where economics is an important subject.

This expertise is lacking in Bangladesh as I myself see who has been teaching here for many years.

However, the expertise could be made available in two ways. Firstly, a structured course with bibliography can be provided by the IDB or by a university, such as, the International Islamic University of Malaysia or Islamabad. In this way with ready-made material and course structure, you can start teaching by hiring your own staff. Secondly, the expertise can be made available by providing personnel capable of structuring courses in Islamic economics. They can be made available by, for example, the Islamic Development Bank, so that the funding problem does not arise, because in Bangladesh there is always a problem of funding. So if possible you can

provide funds for expert personnel which the university will greatly appreciate. If this is not possible then at the very least provide materials and bibliographies to the university. These are my suggestions. Thank you, very much.

**Munawar Iqbal**

As far as your suggestion is concerned, I think that is worth passing it on in the recommendations of this seminar. There should be a committee comprised of people who run Islamic economics program in various universities, e.g., Islamabad, Malaysia, etc., who can design a course for other universities who wish to institute such a program. I think the IDB is the proper forum for doing this. There is a coordination committee in the Islamic Development Bank which takes care of such problems and if a suggestion goes forth from this forum, I think this will be very useful.

**Comment: K. T. Hussain**

I wish to present a correction to what my colleague, Abu Ahmed, has said. Actually, it is not correct to say that the syllabus in the Department of Economics of the Islamic University is not well prepared. I was the major architect of that syllabus, and there is enough Islamic content in it. The problem mainly is the lack of teachers. There are not enough confident teachers to teach these courses. Thank you.

**The Chairman**

I would like to thank brother Munawar Iqbal for his very thought provoking and timely lecture. We are very grateful to him for giving a lot of time to his deliberation. I also wish to thank the brothers and sisters who have very kindly cooperated with us in conducting this seminar, and I also take the opportunity to thank once again the IDB and the Islamic Foundation for giving us a chance to listen to distinguished speakers so that we in Bangladesh can learn about Islamic economics, which is being studied all over the world.

**Thank you.**

***CHAPTER TWENTY-FIVE***

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## **WORKSHOP ON EMPIRICAL RESEARCH IN ISLAMIC ECONOMICS**

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Respected brothers and sisters. Let us start our last session of the day. This session is a workshop on "Empirical Research in Islamic Economics". It will be chaired by M.A.Hamid, Vice Chancellor of the Islamic University, Bangladesh. There will be four contributors: Munawar Iqbal, Monzer Kahf, Salahuddin Ahmed and Syed Tahir. I now invite M.A Hamid to kindly take the chair and the other four contributors to be seated. Thank you.

### **M.A. HAMID, CHAIRMAN**

*Assalamualaikum.* The vice chancellors are meeting every day, so I am sorry that I could not attend the morning sessions yesterday and today. We have another meeting tomorrow at 11:30 a.m. This session's main topic, as I see from the program, is "Workshop on Empirical Research in Islamic Economics". Before we begin I would like to say a few words about the methodology of this session. This is called a workshop on empirical research. We have had seminars in which there were designated speakers, who spoke for one hour or so. Afterwards, we had discussions and anyone could ask questions. To my mind, a workshop is a different thing. I have seen many workshops. You have also seen workshops on the streets. You have seen that in the workshop every body works: somebody is making boards, somebody is making screws, and so on. Everyone is busy in the workshop and probably some supervisor is around to guide but nothing else. In this workshop, I would also expect that everyone would speak. The Chairman of this session will guide, and there can even be cross-discussion. I do not mind if you ask questions and someone gives answers. Everybody may speak in the workshop and I would expect that everybody would speak perhaps for one or two minutes. There can be cross-questions.

Now, regarding methodology, I would expect several things from this workshop. First, we should have some discussion on whether we really need empirical research on Islamic economics. In Bangladesh, as in many other

countries, the researcher and the economist are doing research. They are doing fundamental research and field research. I have also been doing research on economics and rural development for the last fifteen years. I would like to have some discussion on the justification for doing research on Islamic economics.

Secondly, I would also like to invite some discussion on the type of topics or the areas of research. What are the areas? Are we going to deal with topics like irrigation development in Bangladesh on the environmental problem in Bangladesh? Are we going to deal with one special thing, such as, the role of interest or *Riba*, or the distinction between the traditional banking system and the Islamic banking system, or between growth and equity in Islam and the traditional system? I would like to start a discussion on this.

Thirdly, how do you go about it? How do you go about empirical research? Who will do it? Is it the individual person? Is it the institution? Is it IDB, the Islamic University, departments of economics or international organizations? Who will do this research? We should also like to have some discussion on this. Then who will provide finance? Will the university or some other institutions provide finance or will finance come from outside the country? The source of finance should be discussed.

Of course, there are methodological issues, the methodology of doing research. I do not know whether you will be going into that. You are welcome to say anything related to the methodology of research. Are you going to concentrate on a particular topic? Are you going to concentrate on Islamic economics as a whole? Are you going to concentrate on Muslim countries? That is a problem we can discuss if you want to. I do not know whether we shall have time or not.

I would also like to have some discussion on the results of the research, what we expect to get out of it. What are we going to do with the results? Are we going to use them for policy purposes? Are these results going to be published in the form of research bulletins or books and seminar compilations? How do we disseminate the results? At the same time, there should also be an attempt to assimilate the sort of empirical results that have so far been reached. Not much research has been done in Bangladesh; but in other countries, such as, Saudi Arabia, much research has been done on Islamic economics. We can collect materials, too.

Finally, if you want to conduct some research on plan for future action, you can make some comments. Now, these are my observations at the beginning of the workshop. I do not know what methodology is to be followed here. There are four speakers who will speak for some time; I think no more than five minutes, because I am expecting that everyone will participate.

#### **MONZER KAHF'S SPEECH**

*Bismi Allah Al Rahman Al Rahim,*

I believe that we need empirical research in Islamic economics as such. There are many things in Islamic economics that we have taken from Revelation, and we need to see empirically what the results of their applications are? For example, we were told that changes in morality and in the position on morality would affect the consumption function on the micro level and then on the macro level; but that is yet to be proven. The effect of a trust needs to be looked into. Is there any difference between the believer and the nonbeliever? We derive from Revelation some basis in Islamic economics that need to be studied. How do they affect reality? How do they affect real behavior? This, I feel, is one objective.

The second objective is to be really sure that we are going in the right direction, and I am sure we will discover that there are different areas, many perhaps, where there is a need for amending our theoretical approach. So, it is kind of a test of our theoretical approach. What are the important points? The example I can give you is that of *Zakah*. If *Zakah* is only three per thousand of the GDP, it is not important. Everyone can say that it is not important and that it is not going to affect any theoretical analysis, i.e. that it will affect neither the macroconsumption function nor the macroinvestment function. However, if we can prove indirectly that *Zakah* is something like 4,6,7 or 8 percent of GDP, then definitely it will have an effect and then we can justify proceeding with our theoretical research. In the area of theoretical research we have several models or quasi-models. In almost every Islamic macromodel you will find *Zakah* factored in. However, if we consider the collection of *Zakah* in practice, as in Pakistan and Sudan, it is almost negligible. So why do we follow this line of reasoning.



Personally, I find other reasons which are more useful and more important. Therefore, regarding the empirical application of *Zakah*, perhaps we need to show that *Al Akhlaq* (morals) have many areas of coverage, and when we show that empirically, we may be able to come to some agreement with the policy makers, so that the application of *Zakah* can be done in a better way. I think this is also another justification for empirical research being done in the areas most needed, which in my opinion are: Islamic banking, *Zakah*, consumer behavior and producer behavior. Added to these are the effect of moral values on society, on the interrelations in contracts on financing tools or instruments of financing. and on society from a developmental or any other point of view. Therefore, the application of *Zakah* is definitely another important area and it is a vast area. Now there are two more areas that I would like to mention. These are . the more or less descriptive empirical studies on the realities of the economies of Muslim countries and of Muslim communities in non-Muslim countries. These studies can help us identify those areas that can be easily corrected. There are some studies of this kind but hardly any of them are from an Islamic point of view. Studies on Islamic economics should deal with what the problem is, how the problem can be described and how a solution to it can be found.

Lastly, I would say that most of this kind of empirical research can be done individually. Yes, institutional cooperation is required. I can give you an example of a study by the Social and Economic Research Center of the Organization of African Unity, which has its headquarters in Tripoli, Libya. That study aimed at estimating the problem of unemployment among youth in Africa and what solutions can be found to it from an Islamic point of view. Although it is not stated in the title of the study itself, the study was interested in finding solutions from the point of view of Islamic economics. This is one example of cooperation. As for the funding of research, there are a lot of financing institutions or financiers available. I think a good project will always be able to find a financier. If it is done correctly and by the right people, then I am sure it will find the financing to enable it to be implemented. *Alhamdulillah*.

## **MUNAWAR IQBAL**

*Bismillah Al Rahman Al Rahim,*

I will follow the guidelines which have been given by the Chairman and try to answer questions. First of all, he raised the question: Do we need research in Islamic economics? Monzer has already partly answered this question.

Therefore a number of terms of reference related to economic behavior, and we need to know what their empirical implications are. But more importantly, we have different theories, and we need empirical research to test these theories. For example, some people say that if the rate of interest is eliminated from the economy, savings will go down. Others say that since the rate of interest does not mean the elimination of a rate of return to the saver, saving will not go down. Similarly, people say that if *Zakah* is implemented, investment will go up since it is a tax on idle holdings. These theories need to be tested empirically. We need empirical research in Islamic economics.

We also need resources in Islamic economics for the formulation of policies. In all of these models there are certain parameters and the values of these parameters may have important applications for the formulation of policy. For example, we say that in Islamic economics the marginal propensity to consumer behavior is an empirical question. What is the science of that parameter of the marginal propensity to consume. If we determine the value of that parameter, we determine the value of the multiplier and how that will affect the econometric model. For all of these reasons, we need empirical research in Islamic economics. Islamic economics has a distinct theoretical model and all theoretical models have to be verified, checked and modified by empirical field research.

Secondly, regarding the areas of research we need research in money and banking, the firm, the behavior of the firm, consumer behavior, international economics and almost everything in economics. We need empirical research since hardly any work and very few studies have been done. The area is wide open.

Thirdly, how do we go about doing research, and who will conduct the research? Monzer mentioned that generally speaking research can be done individually, collectively or on an institutional level. I would like to add a point which also has a bearing on the next question: Who will finance research? It has been found that some very major theoretical research is done at the level of writing dissertations. That is an area which I think has tremendous potential and is definitely a low-cost research. As far as costs are concerned, if we can finance dissertations in various fields of Islamic economics, the cost is negligible. The return is very good because most of the quality research is done at the Ph.D. level and some institutions have already planned for the funding of dissertations. However, these areas need the further attention of financing institutions. The cost is very low and the return is very attractive.

As far as methodological issues are concerned, there are a number of issues which can be pointed out. Broadly speaking, there is cross-section research and time-series research. As for time-series research, it is usually mentioned in the literature that since Islamic economics is a new science, almost all the experience in Islamic economics, whether it is in *Zakah* or banking, has had a very short life. As a result, there is little data for doing time-series analysis and even that is partially qualified by experiments a few of which have been conducted here. So some data is available, but additional data has to be generated. However, cross-section research is more difficult at this stage in the development of Islamic economics. Cross-section research and case studies are, I think, more important than time-series empirical studies. As far as time-series studies are concerned, there is one kind of time-series study which we can all do even at this stage. We can go back to our history and try to trace the historical fact or historical implications of some of the institutions which relate to Islamic economics. We can then try to project forward to our present circumstances. That is another area to which we can pay attention.

Finally, in the methodological area, I would like to mention that instead of taking some standard model from conventional economics, there is a need even before going into empirical research to have a model which we can apply to our data. We have to develop new models and new variables. For example, when we say that the savings rate is a function of the rate of interest, that may be false in Islamic economics. If say in the banking sector one of the criteria for judging the performance of a bank is the leverage ratio or the equity ratio, that may not be relevant for the evaluation of an Islamic bank. In the measurement of the GDP, the variables usually used may not be sufficient. One important flaw which, I feel, should be corrected is the contribution of women. As we know the household is excluded in the conventional framework. It should not be excluded because we assign a role to the human element, which is the household. We find what person "X" produces is also being done by person "Y" at home. How is this contribution calculated or estimated into the GDP, but if person "Y" is doing the same thing at home, it is not. Since we believe that the role of women is different in Islamic economics. We need to develop new variables that reflect her contribution. Therefore, these are some of the methodological issues presented here as an example, and I am sure other people will come up with more examples. All these methodological issues must be sorted out, and then we should go into empirical research.

## SALAHUDDIN AHMAD

*Bismillah Al Rahman Al Rahim,*

I think much has been said, and I have very little to add. I am talking from the point of view of my experience in Islamic economics and its management. For the last few years I have been associated with the Islamic Economics Research Bureau of Bangladesh. Obviously, when we design our research program, we talk about different models with different parameters and about how those parameters are estimated. In fact, we have prepared research proposals on *Zakah* and we have submitted them to the planning commission and the Islamic Foundation of Bangladesh. There is some difficulty there, but we are trying these sorts of proposals to estimate the different parameters of household behavior. These are the sort of parameters which can easily be estimated by looking at the survey of household behavior. In fact, what Br. Munawar Iqbal said about various theoretical issues, such as, when the rate of interest is eliminated, savings will decrease or increase, is a matter which has, of course, engaged us for several years. But what we need is some sort of framework with which to examine a group of people who have been interested in the falling rate of interest and savings. The only place we can do this perhaps is, *ceteris paribus*, with group of people who are customers of Islamic banks. However, for this we need baseline research. In fact, for many of the things that we want to do, we have to create a baseline. That, I think, is one of the most important tasks for the field of Islamic economics. People can see the impact immediately when a baseline research is created. They think it is important, and perhaps as Islamic economics develops, Islamic politics will develop. Think of changes in policies. You saw certain policies in 1980 and others in 1985. So, as policies change, we can make comparative studies. Certainly, one of the most important forms of modern empirical research is baseline research. Today, I do not see changes in interest rates, so I cannot see their impact. I think empirical research is a broad analysis which looks at existing policies, analyzes the various causes and sees the impact of them. For example, if a change in economic policy took place in an Islamic country, what would be the impact of Islamic norms on the outcome of this change? A *Zulm* or injustice parameter of certain policy change may be estimated in a baseline research. This approach will allow you to estimate a lot of things in relation to Islamic economics. The *Zulm* parameter rises over time as different policies change.

This is what we have been doing in the budget and irrigation project. Hameed has done a study in irrigation policies, etc. This is one thing we have been doing. Another thing which we have been doing is

developing strategy. In developing strategy we are managing one action research project. However, there are different premises which you get from the *Shari'ah*. Now the question is: how we can apply this? In the past, we have taken a small village and made a total socioeconomic profile of it. We have taken a mortgage-based economic development program, for example. Br. Aziz is not here. He is from the Islamic Development Bank in Bangladesh. He has done a baseline study on the village and has collected baseline data. He has used mortgage-based development strategies. Different strategies, all of which are *Shari'ah* based have been undertaken, and then after a period of two years another set of data will be collected, and we will see the impact of the different strategies. This is the type of empirical research that we have been doing. We are not criticizing other people. I will make a further conclusion about this later.

Let us turn now to the issue of institutional improvement in Bangladesh, with reference to the Islamic Bank. Islamic banks, were started in many countries and have grown slowly in time. Empirical research has been conducted in order to improve the institution and different policies have been undertaken. The relationship with Central Bank and what are the features which Central Bank requires from Islamic Banks? As Br. Munawar has suggested, the research areas include the following: the impact of different modes of financing on customers, how the accounting system should be looked at in the existing financial system, the application of the Islamic *Shari'ah* to the real estate and the accounting policy. This is what I see as empirical research in Islamic economics in the context of Bangladesh. Now I am asked whether these kinds of studies are necessary all over the world. My brothers here are from different parts of the world and they can tell me. However, I think this sort of research is applicable all over the world, because our objectives are the same. In order to Islamize economics, we have to be concerned with the improvement of institutions. We have the appropriate institutions, we can do all sorts of empirical and theoretical research. Each country has its own policies and analyzes its own policies. In terms of existing policies, the impact of economic research, I believe, lies in creating a baseline for change. Once you show what these policies are doing in terms of human welfare, you are creating public opinion for policies, and policy change creates grounds for empirical research, you then can get another set of data and see the policy change and the impact of this sort of policy change. This can be done everywhere.

Finally, development strategy, depends on the political environment in different countries. In Bangladesh, we can go to the village and collect data. We can undertake a mortgage-based development strategy and we can do this in

other places as well. As far as the question of who can do this research is concerned, I think that the individual is important. I have found from my fifteen years experience that the individual can work, but he needs the support of the organization. The individual has feelings, he comes and goes, has ideals etc. Because of the coming and going of individuals, we need strong academic organization dedicated to research. In Bangladesh, we have an academic organization, like the Islamic University which will do Islamic training and then we have purely research oriented organizations such as, the Islamic Economics Bureau. However, there is no link between these two, and I believe that without this link, you will not be able to succeed. I do as much as research I can, but I do not have all the new literature which is being published. Other brothers from Bangladesh will be able to corroborate this. However, if academic institutions and other such institutions combine, they will be able to have all the available research literature. For example, I have recently developed a mathematical model to monitor certain changes in economic policy. I was able to find some financing to get some literature, but I still believe that I have not received all the literature. So if the efforts of the Islamic University and Islamic Economics Institutions are combined in the context of Bangladesh, perhaps, we would be able to conduct research in both academic and empirical manners.

As far methodology, of course, I agree with Br. Munawar Iqbal, that the cross-section at this juncture is very important for the creation of the baseline. My ultimate objective is the Islamization of the country. Let me be very frank. I want the Islamization of the economy. If I do not have a baseline and go on collecting data on a regular basis, how will I know what the policy is, what the government pronouncements are and of what they are doing, in fact, is having an impact on the economy? So this cross-section with the purpose of creating a baseline is, I believe, a good project, if you can get the funding. However in the context of developing countries, like Bangladesh, it is very difficult to get funding, because the links with international organizations are not very strong. The Islamic Development Bank operates at the government level. If you are a private researcher, you cannot have access to the funds of the Islamic Development Bank. You can submit a proposal to the government, but the government machinery is very time consuming. Brother Juri Islamy, here submitted a proposal on *Zakah* for government permission about two years ago. They sent it to the Islamic Foundation. Now the Islamic Foundation is studying it. If, it takes three or four years to secure funding, all enthusiasm is lost and brother Juri Islamy may go abroad. This is what happens. So getting funding is a critical problem. I agree in principle that a good project, *InshAllah*, should be able to get funding. However, this does not happen in the context of

Bangladesh. There are a lot of difficulties. Many brothers may refuse to do research because of this constant problem of funding. Finally, when you present your results, the government may not even accept them. However, in a Bangladesh, a lot of the things that we have done, have been acceptable to the government. The government has made use of lot of research.

Thank you.

### **The Chairman**

Thank you Br. Sahabuddin Ahmad. Now our final speaker is Brother Sayyid Tahir.

### **Sayyid Tahir**

Thank you, Mr. Chairman,

Dear Sisters and Brothers,

*Assalamu Alaikum Wa Rahmatullah Wa Barakatuh*

My background is mostly in theoretical studies, so I will try to stretch my imagination and make a few points on the possibilities of empirical research in the area of the Islamic economy.

Empirical research can be tested to establish the research validity of various studies. Alternatively, empirical research can be either policy-oriented research or applied research, in general. I will try to explain what I mean by this. For the purpose of testing you can have full-scale empirical studies to derive a consumption function first from an Islamic perspective. What the consumption function would be at the micro level perhaps or at the macro level? At the most sophisticated level, you can have a full scale model consisting of many relations in order to see how far it can be accepted on empirical grounds. These areas require some groundwork especially in the case of the full scale model.

For proper theoretical work, we still have a long way to go before meaningful attempts can be made at testing. On the theoretical side, there is scope for testing basic relations such as, the contention function that I have mentioned. For example, suppose that we all attempt to establish an

organization of profit assumption. That is fine, but what will be the alternative Islamically acceptable behavioral hypothesis. How will be Islamic businessman or entrepreneur or producer have? What will the objective function be? What will be maximize or minimize or whatever? We find this basic kind of research in all the areas of consumption, you are all aware, and the emphasis is on moderation and *non-Iraf* etc. There are certain areas of economic study which are common to us all Muslims or non-Muslims, because they describe fundamental behavior, such as the diminishing margin of utility. Now, we have to link this idea of the diminishing margin of utility and perhaps come up with a working hypothesis on how to define its effects. How do you defined in the relative terms. That kind of basic research, I think, is carried out more quickly by applied research or policy oriented research. It can be a comparative analysis of the Islamic versus of the non-Islamic environment. For example, what would the effect of Islamization on savings be? In other words, while posing this question, I have in mind people who are behaving in a non-Islamic way. Let me repeat: What is the fundamental difference between the behavior of non-Muslims and Muslims? How does being a Muslim affect the saving behavior of people? Once you are able to trace difference, you can make some generalizations.

Then in the area of policy-oriented research, we can carry out some work, such as, in the area of corruption. What factors cause corruption? We can also look for further Islamic policy in other areas. I would say, that Islamic policy of how to achieve a particular objective. For example, *Zakah* can be distributed in cash or in kind. What are the implications of these alternative ways of distributing *Zakah*? This is a potential area of fruitful implications for policy makers, so we can devise such topics.

I feel that there is a much larger scope right now in general applied research. For example, in Islamic banking, we have good cooperation but no practice, or at least inefficient practice thus far. In this regard, research, could be sponsored by anyone who is interested in Islamic banking. For example, what is the viability of establishing an Islamic bank in Dhaka? You select the locality, identify the customer, and then with that customer, you study the Islamic characteristics, the income profiles, and the income levels of various people. You also study the preference of various people for saving. Some people save money for three months, some for six months, some for one week and some for one year. Depending on all kinds of systematic data available, you can foresee the viability of establishing a bank. What types of instruments should it offer in order to attract various kinds of funds? There are many possibilities to consider



and before applying any of them we need to study how viable they may be. Similarly, there is the possibility, as my colleague mentioned, of looking into the past of the whole Muslim state and of studying various historical economic relations. I anticipate that this is another useful study area. As you know the backwardness in Muslim countries did not come about overnight; There was of course, a lot of systematic study. One studies in the United States on income consumption provided the basis for American theories of consumption. You know that type of issues are involved in constructing those data series. Perhaps for Islamic economics, we can also adopt some of these techniques and try to imagine various relations in some parameters and work out possible sets of data series on typical data on which to establish our theories. These two things in my view are possible in terms of significant topics of research.

Beyond this, of course I do not need to mention that most research depends on your own problems. It can be purely statistical research and it can be econometrics. If you are involved in a study comparing Islamic versus, non-Islamic issues or sectors contributing to a particular thing, you might as well be engaged in sector analysis depending on the problem at hand. I am more concerned about who will do the research because cooperation has been deemed a part of Islamic technology. In Islamic economics there is a tendency to want to centralize and coordinate everything. I remember some of the opinions of this institution, that it should coordinate research activity so that there is no duplication. We have to correct this point. You should all feel free to work on the same topic on which I am working. It is necessary that more than one person be working at the same time on similar problems, so that we can compare our notes and results and, *InshAllah*, progress more quickly. I feel that we should get rid of this notion of coordinated results.

As far as funding is concerned, if you want to do the real work, do not accept funding because funding means that the funder has to be not always an understanding of the type of work you are doing and its importance and you may end up distorting what you really want to do if there is some funding available.

### **The Chairman**

Thank you, very much. You have listened to four speakers. I have initially raised some issues. I did the following. I submitted a report on what I had done and included on my team one real Maulana of the Arabic Department of Rashtriya University. I stated the amount of money that I needed and have

given details of the proposals and sent it to that institute. After one or two months, I got the reply which said that the research was accepted by the institute. We have asked for a 25 percent advance, but the reply was, your research was accepted but unfortunately, we cannot give any advance. Please complete your research and submit the final report and if the report is accepted, we will refund the entire amount that you have demanded. If your report is not accepted, we will refund your typing expenses. Those were the comments that I received and from that time, I lost all interest in research and funding.

### **Comment**

One point that arises in my mind regarding Islamic research is that you mentioned that one Maulana was included in your team because you thought that you actually did not have an Islamic background, that is, that you did not have a knowledge of the *Shari'ah* and Islamic theology. I think that if you want to do research in relation to Islamic aspects then definitely you must have a theological knowledge and, therefore, you must have a good background in the *Shari'ah*, Holy Qur'an and the *Sunnah*. However, the difficulty is that we do not have access to the Arabic language and that is why many of the books have not yet been translated in any other language. Some of them have, but many still have not been translated in English and Bengali. Most Bengalis do not know Arabic and, therefore, as we do not have access to the language, it is very difficult to get the required background. The Arabic language is difficult and if you want to go into the subject deeply you have to understand the difficult matters mentioned in the *Shari'ah*. Therefore, we have to learn and for that the translation of those books is essential. You have to have access and as Salahuddin mentioned, for that teamwork is necessary. It is a very difficult job for the individual. Therefore, the Islamic bank, the Islamic Research Bureau, the Islamic Foundation and also if necessary laymen should all join together and if those books are available in the Arabic original, let them be translated so that we can engage in this type of research.

I would also like to suggest that in the first stage in the new university curriculum of Islamic economics, some papers on Islamic economics should be introduced along with dissertation work. In most colleges in economics, there is no dissertation work, especially on theory, but I think that one or two papers should be introduced in the university curriculum for Islamic economics. This is the first step and also in Islamic research we must have relevant books translated into English or Bengali or other languages so that we can go on actually doing research. I agree with my brothers when they point out that whatever research

methodology we use, it is definitely difficult for a particular individual to get research funding and, therefore, cooperation is required. Brother Hameed mentioned that the Islamic Research Centre, Jeddah could possibly be of assistance. However, they may have to change their attitude towards funding such research. I think that if we proceed slowly in this direction, we will be able to succeed. Thank you, very much.

We do not like the maximization of profit. No one likes it. I protest. I do not like it. I do not stand for the maximization of profit in the Islamic economy. Another point that it was mentioned, we all know that the role of woman is at home. My daughter, would kill me if I agree to that. The role of woman is as much as at home. The Prophet (Pbuh) said, "*al Nisa' Shaqaiiqu al Rij'a*" (woman are the equal twin of men). My wife, my daughter at least believe in that women are equal to men. It is the same as taking one piece and splitting it into two halves. You can work outside just as well as you can inside. It is the same thing for women.

### **Comment**

I think, the subject of research is of great importance particularly when we are talking of the Islamic economy. At the same time teaching at the university level is linked to other factors. As a matter of fact what we teach at the university level is the result of research and these days most of what we are teaching is wrong. This is because what we are teaching is almost always the findings of research in advanced countries not in our country. Conspicuous consumption is a good example. We should teach about things which are applicable to our society, which have been formulated in our society or in the context of underdeveloped countries. Therefore, it is possible that we are giving our students the wrong story. At present we are talking about an Islamic economy. We are actually about to experience a revolution as was clearly pointed out by Munawar Iqbal and other speakers. Munawar Iqbal particularly mentioned terminology and certain assumptions. If we think about these things, we have to change the whole approach to economic analysis and this can be only done by what is known as fundamental research. Well, it is not that easy to undertake fundamental research. We have to undertake regional research on serious matters in order to get the correct information to teach our students. I repeat that what we are teaching is mostly wrong. Therefore, it is of great importance for us to undertake research in order to have a better knowledge of the Islamic economy which is linked to our own tradition.

## **Comment**

I have three points and one suggestion to make.

First, we wish to engage in empirical research. Why? We must find out. We must point out the problems of empirical research, because if we cannot determine the problems, that we are facing in the modern anti-Islamic society, then we will not be able to engage in empirical research. Why? We are under the Western civilized world and the Western economy. As a result, it is not possible on our part to engage in empirical research. Therefore, we must determine all the problems and shortcomings related to conducting empirical research on the Islamic economy. This is my first point.

Secondly, as my teacher Sulaimn Mandal said, priority should be given for empirical research. Why? What should our specific priorities be? What is the first priority? What are the alters? We cannot make the entire economy Islamic overnight. We must determine our priorities and then we must get to work.

Thirdly, I wonder whether this empirical research is at all possible under the prevailing unIslamic economy, socioeconomic and political system. As Salauddin Saith said: Research is not being financed or supported by society or the government. So how it is possible? There are many economists and intellectuals but there are few Islamic economists. How can we create an Islamic economy under these conditions? This is my third question.

Now, finally my suggestion to the IDB. Since we lack the Islamic economics books at the different universities, I suggest that the IDB supply these books. A list has already been published by the IDB or by the Islamic Research Economics Group. They can supply the books to all universities in Muslim and non-Muslim countries so that we can make it clear that Muslim nations have an Islamic economy and Muslim students can have the scope for further research work. Thank you.

## **The Chairman**

I now request Ahmad Siraj in the back to speak.

## Ahmad Siraj

Regarding the mythology of research, I would like to point out that the proposed mythology for research is not clear to all of us. I would like to talk about it, so that it can be better understood. Imam Ishaqi in his book, wrote of the correct direction for research in the Muslim World. Such research was possible only after Imam Ishaqi's book which started the Islamic research in the third century. So we know how to take hypothesis or assumptions, how to look at them and how to determine which one foils and which one can be proved to be right. All of these things are explained in the *Huqulilsak*. These discussions of methodology are from a scientific point of view and many believe that the *Huqulilsak* is the correct way for an Islamic society. There is another observation about the field of research about the Muslim world. We all tend to think of the *Ummah* as a whole and of the unification of Muslim countries. Research in this direction is also very important. Therefore, I would like to suggest that research centers somewhere in the Muslim world should assume the responsibility for research in the Muslim world and then whenever and wherever Muslim students or researchers need survey materials, they can contact this center in order to get the appropriate data. I think that more important than financing research is extending help and assistance to Muslim researchers by providing them with the data that they need. Thank you, very much.

## The Chairman

Thank you, very much for a very good suggestion.

## Comment

I want to mention empirical research especially in reply to a point raised that Muslims are not committed to religion and so on. I think in our society, even non-Muslims are half-Muslims because Islam is deeply rooted in our habits and culture. It is not only a question to whether someone is committed to the Islamic movement, or anything of that kind. An example of this is those studies, that were done by one of our colleagues in Islamic economies, Ahmed Lashkar in Scotland. He studied investment and he ran a study on the behavior of Muslims in Edinburgh and compared it with the behavior of non-Muslims. He found only minute differences between them and he wrote a small paper about it. It was interesting to see that even there where you find that a commitment to Islam is probably only hidden or dormant, i.e. not it was visible, because Islam

is more, deeply rooted than we realize. In Muslim countries of course you find more of this. There are several studies that have been done by graduate students in Saudi Arabia at the university in Makkah, and others that are in my own opinion also valuable because they are trying to select those elements which make a difference and they are always comparative. I think that these are very important.

### **The Chairman**

As I have to leave, I request Salahuddin to preside. I thank you very much and will see you again tomorrow.

### **Comment**

I am Mohammed Jaffer. Thank you Mr. Chairman for kindly allowing me to make some observations. While talking about empirical research in the Islamic economy, in my opinion, we should keep to absolute research and comparative research. By comparative research, I mean, while carrying on research in Islamic economies to prove and explain its practical implications and its theoretical and practical supremacy over conventional, so-called mainstream economics. We should also try to expose the contradictions in methods and policy measures adopted, by so-called mainstream or conventional economies. It is a new development that some Western economists that so-called Western economic jurists are not in a position to solve the basic problems of mankind. Officially, those people are living in mental disarray. Perhaps some of you attended a lecture given by Anisur Rahman, a noted economist of Bangladesh. Of course, he is a conventional, not an Islamic economist. He gave a lecture on the moralization of economic association in a meeting last year and he has published in many dailies. In that lecture he has mentioned a functional phenomenon, that many conventional economists have admitted that economic jurists of the conventional method have failed to solve the problem of poverty, especially the majors who have estimated development growth profits of those countries and especially these methods. Western methods are harmful for those innocent countries because Western jurists, and Western methods may create problems for development. From this point of view I feel that while we are talking of empirical research in the Islamic economy, we should work on dual factors. In one sector, we should work for improving the supremacy of the Islamic economy and in other fields we should expose innocent addition and conflict of so-called Western economic jurist and statutory. Thank you.

## **The Chairman**

If you could be brief and to the point more people will get a chance to speak.

As far as the publishing of empirical research is concerned, there are a few journals which have been published by the Center. However as far as I know, there is no journal which deal with the theory of "MUSLIM" theoretical research. There is one journal published by the Empirical Research Bureau that cover a few empirical research projects, but it does not deal with anything theoretical. There is another journal published by the Islamic Economic Association. The first issue is now out, but it does not have any empirical research. There are two journals which are published by the economists at the Malaysian Islamic University, but they also do not cover empirical research.

However, there is unpublished work, which makes some attempt to deal with the theories of empirical research. The Islamic University of Islamabad, for example, has empirical research on banking, and there are some empirical research projects in the Islamic Economic Research Bureau at Bangalore on Islamic banking, etc. However, this research is as yet, unpublished. This is why the topic has become very important today, because empirical research projects are few and far between. The objective is to encourage empirical research. So far, research projects are mostly in the area of theory. When a person wants to run a model, he needs the parameter value and parameters are most of the time difficult to evaluate because of lack of data.

## **Comment**

Thank you Mr. Chairman. I think that this meeting is for the purpose of explaining some significant points. There are some isolated efforts applied to statistical work related to our objective. Mostly, these statistical projects come from the IDB and are on the nature of Muslim countries and on what the Islamic banking experience has been so far. Little of sort of information is available. There is a study, which I remember, by Irna Adleman and Peter Morris published in the World Development Countries. Both used sectors analysis to compare the issues across various items and they considered Islam as a sector. I read this study five years ago but unfortunately I do not remember this reference. You can check further article under Irna Adleman published by World Development. By and large, the message is that we all need some direction in order to identify the priority areas so that, in a short time we can all

conduct the maximum amount of research. Some efforts have been made by the Center for Islamic Research in Islamic economy and development banks are also doing this kind of activity. What are the priority areas? However, today the most important area would be the failure and success of the Islamic banking experience and also *Zakah* implementation. I also have one small observation. If sponsored research can materialize, then that is all right, *Alhamdulillah*. However, even if no money is available, there are many topics which you can still work on without any external support just by using your calculator or your personal computer. This method involves identifying the issues and handling them intelligently.

I want to conclude by saying that it has been a very exciting session. As for myself, being a theoretical worker in Islamic economies, I built a mathematical model in my thesis to get a certificate in a few days' time. If the variable has a certain shape, it would have a positive impact and if the variable has a different shape, we say from our Iman that this will be the shape. I think we will have to go out to the real world to see what the real shape of this variable is. There is the shape of marginable publicity, as Brother Munawar said and so many other variables. You really must go out to the real world and find out what the aspects of variables are. Most of the time, brother Bar and brother Khan are just tracing the variable and then simulating the impact of the variable. I think this has been a very important seminar. There have been a few attempts to publish empirical research on the Islamic economy. I think that this workshop has made an historic contribution. We have gathered together, made some very important suggestions and formed a committee.

### **Munawar Iqbal**

The point I made was that from an empirical point of view, the majority of the work the women do is in the household because of the comparative advantage. Allah (SW) has created man and woman with a different nature. Even in those societies which permit women to do anything they want, if you collect empirical data on the kind of jobs which women do, you will find that they are doing a job which relates to the household, such as, baby sitting, nursing, teaching, etc. These are the kinds of things which women do. Allah has created them in such a way that they are kinder than men and they are more efficient in doing things. All of these characteristics have been given to women by Allah. That is why I said that women have a greater role in organizing the household and their contribution should be recognized.



Another point which was made by Syyid Tahir was that there should not be any coordination, but I disagree with that. Coordination means that people should know what others are doing. If we know that on the same subject there are five different institutes, or that five different people are working on it. Fine. We have to take a consensus between them since the sources available to the discipline of Islamic economics are limited. We have to have our points so that we can arrange ourselves accordingly. That is all.

#### **The Chairman**

I want to thank all the participants for their active participation. May Allah bless you for this contribution to Islamic economics. Thank you.

***CHAPTER TWENTY-SIX***

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**PANEL DISCUSSION:**

**DEVELOPMENT OF CURRICULA FOR  
ISLAMIC ECONOMICS AND  
ESTABLISHMENT OF ISLAMIC  
ECONOMICS DEPARTMENTS**

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**The Chairman**

I first invite M. Anas Zarqa to contribute his ideas:

**Anas Zarqa**

This panel discussion is directed to address important topics meant for department of Islamic economics. There are three objectives:

1. To establish Islamic economics programs at the university level with the required elements and to develop appropriate curricula;
2. To determine what kind of manpower is required, and
3. To develop appropriate teaching materials.

Therefore, our discussion should focus on these three elements. I think we should, *InshAllah*, come up with something concrete and definite in terms of curriculum, manpower and teaching materials. We should keep in mind at all times that we want to come up with some specific, workable recommendations. So we should try to concentrate on the applicability of any suggestions that we make. We do not think that certain things are impossible to achieve in a reasonable time. With this conclude my brief introduction and request our brothers to comment on these elements. Can we take the matter of curriculum first and after we can move to the question of manpower and then teaching materials. This will be convenient for us.

### **A Participant**

One Moment! If we had been informed beforehand, we could have sat to work out a curriculum for the introduction of Islamic economics in the universities of Bangladesh. I am speaking in the context of Bangladesh. I would replace the word "development" in the title of this panel discussion with the word "preparation" or "framing" of curriculum because in Bangladesh we have not yet introduced Islamic economics for teaching at the university level. No question of the development of curriculum arises here; we need to introduce Islamic economics. So we should prepare or frame the curriculum and find out the ways and means of establishing departments of Islamic economics in universities as well as in affiliated colleges. I have worked out a brief outline of the curriculum of Islamic economics and the establishment of an Islamic economics department.

### **Anas Zarqa**

While preparing a curriculum on teaching Islamic economics at the university level, we have to take into consideration a number of issues which may be regarded as essential prerequisites for introducing this academic discipline for graduate and postgraduate students in universities and colleagues.

These are the subjects to be taught in Islamic economics as a whole, divided into different papers.

Distribution or break-up of total marks per paper, that is to say, a full paper or a half paper carrying one hundred marks and fifty marks respectively. Detailed content of the paper or the syllabus of teaching. Total number of lecture hours required for each paper during the academic session. Number of teachers required for teaching each paper. Supply of textbooks and library tables available both to teachers and researchers and the reorientation of faculties that may be provided to teachers to enhance their teaching.

The development of curricula for Islamic economics and the opening of Islamic economics departments in the Universities of Bangladesh depend upon whether Islamic economics will be introduced as one of the compulsory, alternative or elective papers at the degree or master's level in the university and its affiliated colleges through their respective departments. We know that, at present, we are teaching conventional economics at the graduate and postgraduate level, which is the economics which prevails in the modern world.

Once Islamic economics attains the status of a full-fledged departments, the teaching of Islamic economics will not be limited to one paper only, but will cover a total course with several papers. This type of education may be introduced only in Islamic University. Insofar as the teaching of Islamic economics at the university level in Bangladesh is concerned, it may be introduced as an alternative paper, that is, only one paper carrying 100 marks in BS/BA, honors and MA or MS classes. In Dhaka University the honors classes have one paper which carries 100 marks divided into two parts. Each part is worth 50 marks. The paper, Economic Development and Planning, covers economics of social groups.

It is my suggestion that if we introduce Islamic economics as an alternative paper or subject at the honors level, the choice for the students will be between the economics of socialism and Islamic economics. Development planning will be a compulsory paper. Similarly, in the master's classes, there is a full paper carrying 100 marks in socialism, that is the economics of socialism. Here we may also introduce Islamic economics carrying 100 marks in the master's classes as an alternative to the economics of socialism. The choice will be left up to the students. The alternative will be determined by the committee of courses and syllabus but the selection will be left up to the students. I have not worked out the detailed content of the syllabus for teaching Islamic economics. The teaching of Islamic economics at the university level and the establishment of Islamic economics departments requires the recommendation from the Ministry of Religious Affairs to the Ministry of Education. There should be, a, directive from the Ministry of Education to the Vice Chancellor of the Islamic University that Islamic economics should be introduced as a new academic discipline. We will also require the approval of the Academic Council of the university as well as the University Grand Commission.

I also suggest that the teaching of Islamic economics at the university level in Bangladesh be introduced not as a compulsory subject, but rather on an experimental basis. I think that we shall get a good number of students. To make the program successful, we require a supply of textbooks in English and their translated version in Bengali. The compilation of leading issues or readings in Islamic economics containing articles collected from journals contributed by Muslim scholars is the first necessity. These are the curricula requirements for the establishment of an Islamic economics department in Bangladesh. Thank you, very much.

**Second Panelist: Abdul Hamid**

My brother, Mohammad Abdul Momen of Sadat College, has just now expressed his views on the subject. Now before I start, I wish to express my gratitude to the organizers of this seminar for giving me the privilege to take part in the discussion on the introduction of Islamic economics at the university level. To such an august gathering, probably the first of its kind in Bangladesh, I intend to speak first on the potentiality of the Islamic economic system then a few words on framing the curricula on Islamic economics for the university level, and, finally, I will try to put forth some suggestions or recommendations for making the program a success.

The seminar on the Teaching of Islamic Economics at the University Level is being held at a crucial time when the subject of Islamic economics is of paramount importance. The whole world is now divided into two blocks: capitalism and socialism. Both systems have failed to mitigate the sufferings of the people and to solve the economic problems of the day. As a result people are now experiencing the bitter failures of the two economic systems. This is why all over the world people are now eagerly awaiting an economic system which will save them from these two systems. People now want relief. It is Islam and Islam alone that can give us relief from all sorts of social injustice and save us from total frustration and complete destruction.

We, Muslims, believe that Islam is the complete code of life and that it is superior to all other ways of life. But mere belief alone will not help us to achieve our cherished goal. We must transform this belief into reality. This task is no doubt a complicated one and requires theoretical and practical research, so that a full-fledged Islamic economic system can be brought into being around the world.

I have attended this seminar for the past twelve days. By now a number of intellectuals, researchers, educators and thinkers from Bangladesh and abroad have presented valuable papers and taken active part in the discussion.

**Third Panelist:**

The valuable discussion that has so far taken place will help us to better understand many complicated issues of Islam, and of Islamic economics, and it will provide guidelines for the teaching of Islamic economics at the university level.

While taking part in the discussion a few days ago, Abu Ahmed of Dhaka University who is at present the honorable Chairman of this session and the respected teacher, Mohammed Abdul Hamid, who is now Vice Chancellor of the Islamic University, told us that they tried to introduce Islamic economics at the university level but that they had failed miserably because of the resistance or noncooperation from a group of their colleagues. This type of resistance, I think, may be because of either noncooperation for reasons best known to them, or because of ignorance of the inherent ideals of Islam. At present Islam is taken by most people, particularly by the young, to be a religious affairs. This misconception of Islam must be removed and in order to do this a detailed program of research, keeping in mind the fundamental teachings of Islam, must be undertaken. It should be the duty of the Muslim economists and researchers to study, analyze and make suggestions as to the application of Islamic economics to various aspects of our daily life. This is very important. If we can make people understand the inner ideals of Islam, then the Islamic economics system alone can bring peace to this troubled world, and then I am sure that young people will exercise their efforts in this regard and Islamic values will be reestablished.

As regards the curriculum for the teaching of Islamic economics at the university level, I would suggest the formation of a committee comprising experts on various issues. If Islamic economists would sit together to discuss the issue and in the light of the paper on the teaching program in Islamic economics presented by Munawar Iqbal, a curriculum for teaching Islamic economics at the university level can be devised.

**However the following recommendations can be made:**

- I . In view of the resistance of a group of teachers to the introduction of Islamic economics at the university level in the past, I think Islamic economics should be introduced at the university level by force. At first, it should be included as a part of the economics paper with 25 or 50 marks and after that a paper in the Department of Economics may be introduced. Later a Department of Islamic Economics may be opened.
2. The papers presented in the various sessions should be published for wider circulation at home and abroad.
3. The government's sincere desire is essential for introducing Islamic economics at the university level. The government should be persuaded to make the necessary arrangements for introducing

Islamic economics at the university level, as was the case in the introduction of the economics of socialism at the university level after the war of liberation in Bangladesh.

4. Various seminars similar to the present one should be organized by the Islamic Research and Training Institute in cooperation with the Islamic institutions, such as, the Islamic Development Bank, Al Baraka Bank and the Islamic Foundation. Some seminars should be organized from time to time at the divisional and strict headquarters level in order to create awareness on the applicability of the principles and institutions of Islam in solving the problems faced by the community.
5. An Islamic research institute should be opened at the divisional and district level to be financed by institutions, such as, the IDB and the government. This institute should undertake research projects for the solution of the social and economic problems of the day.
6. Effective steps should be taken by the Muslim world to build up an Islamic monetary fund along the lines of the IMF.
7. Journals and books on various Islamic issues should be published for which purpose separate boards, such as, the National Curriculum Board and the National Curriculum and Textbook Board should be established.
8. The necessary arrangements should be made by the organizers of this seminar to supply journals and books on Islamic issues published outside the country to universities, and university-level colleges, particularly participating educational institutions.
9. Government of the Muslim world should come forward to implement the ideas of Islam for building an Islamic economic system.

With this, I pray to Allah the Almighty to guide us on the right path and help us in attaining our cherished goal. I thank you all.

**Farouq (From Patuakhali College)**

It would have been better if the topic of this discussion, "the Development of Curriculum for Islamic Economics and Establishment of Islamic Economics Departments at Various levels" had been given to us earlier so that we could have had more time to think about it. At any rate, last night I



gave some thoughts to this problem and there are some points that I wish to make.

What Hamid has said about resistance needs to be looked at in detail. Traditionally, there has been resistance to the establishment of Islamic economics at any level. However, I think there is little chance of resistance today and that we can proceed with our curriculum and the introduction of Islamic economics at various levels. I think the matter has been divided into three parts i.e., the curriculum at the university or at other levels, manpower and teaching materials. I also think that there should be language materials and, finally, I would like to talk about the replacement of the syllabus of socialism.

Curriculum, I think, means the aspects of the syllabus, i.e., how the whole matter will be split up for teaching at various levels. Much has been said about it by two previous speakers, but I would like to add something to it.

I think that the matter must come down to the college level. I know that we are discussing a curriculum at the university level, but we should think of bringing it down to the graduate and even the intermediate levels. I think something must be done before the university level because if students from the primary and secondary levels have this subject at the graduate and postgraduate levels, there must be preparation for them to receive the teaching at the graduate and postgraduate levels. They must have some knowledge about the *Shari'ah* and *Fiqh* and also about Islamic economics or general economics. So for this purpose I think some sort of paper of 25 marks at the intermediate level-can be added.

There is a syllabus for the teaching of socialism. I think this can be replaced by a syllabus of Islamic economics. Some knowledge of the *Shari'ah* and *Fiqh* is needed because our students will all be Muslim students and they must have some background beforehand. So if they are given the chance of learning Islamic economics, the *Shari'ah* and *Fiqh*, surely they will be able to understand them. The syllabus should start at the graduate level in university and college.

I must say that I am speaking only in the perspective of Bangladesh, but I think that in all Muslim countries, the stages of education are similar and, therefore, I think you can have a clear idea of what I am saying even though I am speaking only in terms of Bangladesh.

I think that at the graduate level, there must be a paper on micro- and macroeconomics side by side with a paper on Islamic economics and another on language. At this level students can choose English, Arabic or Persian as their language.

The postgraduate level is a very specialized level of learning and the choice of language will be open to the students. They can take any language, Persian, English or Bengali, and there should, I think, be two papers. One should be about the complicated aspects of the *Shari'ah* and *Fiqh*. They should have a clear knowledge of them, and the other paper should comprise 100 marks. The second paper, comprising 100 marks, macroeconomics should be compulsory because we are going to establish something for the interest of the Muslim community. This should not be a subsidiary matter. It should be compulsory, I think. Regarding the problem of manpower, in the first instance, we should be able to teach something because we have been able to learn something and it has even been possible for us to sit together for give and take. We should at least be able to deal with.

The *Shari'ah* and *Fiqh* because of our background. We must, however, be provided with books and other materials to teach the *Shari'ah* and *Fiqh*. At the university level, the teachers from the Arabic and Islamic Studies Departments can be invited to deliver lectures on Islamic *Shari'ah* and *Fiqh*. The teachers in the Department of Economics will, of course, deal with the paper and the students are likely to be given research work. Then, the more comprehensive course must be , delayed, it must be retarded now at this stage. Because - if the whole thing flourishes within five or ten years then the matter will be open to them. Research may not be possible at this stage. By this time teachers will be trained for the graduate and postgraduate levels. This is a serious matter and it cannot be dealt with in an ordinary manner. So by this time we should have trained teachers. We must get a thorough knowledge of the syllabus by going through the appropriate materials so that we can import something fruitful to our students.

As for reading materials, I think that there are some books now in this country and, of course, in other Muslim countries. I also have some books, and I think you do as well. These courses will be in English, but for more sophisticated study, we should have more translated books. For this purpose, there should be a translation group. You may form a committee responsible for the translation of important books like the Bangla Academy here in our country

The committee should comprise, I think, people from the *Shari'ah*, from the *Madrasah*, from *Alia Madrasah* and from other economics.

Language should not be a problem at the postgraduate level, because postgraduate students have a knowledge of Arabic, Persian, English, etc. The problem instead is that of research work, and students who are going into research must be selected by the universities on the basis of their knowledge of the materials. So I think it will not be a problem at that stage.

As for socialism, this is a topic that has been introduced and taught at every level in economics even at the intermediate level. At the graduate and postgraduate level there are syllabuses for socialism. However, I think that these should be replaced. Nowadays Gorbachev has introduced the principles of democracy into socialism. So the teaching of socialism should be replaced by Islamic economics. It is not replaced then the minds of the students may remain open to socialism.

As far as the syllabus is concerned, I think that at the graduate level, there should be a paper on the various aspects of production for 100 marks. A paper for 100 marks should be offered at the postgraduate level. These two papers will also deal with various aspects of production, as well as tax, the law of inheritance, public finance and fiscal policy. I think that later we can consider insurance, Islamic insurance, *Zakah*, international economics, nationalization of industry, etc., and gradually the entire perspective of Islamic economics may enter into the syllabus. I have spoken of some aspects of the development of a curriculum for Islamic economics. I think that in other parts of the Islamic world the matter is more developed. I hope to give some thought to my understanding of the concept of a curriculum and syllabus which may be applicable in our country. Thank you, very much.

#### **Chairman**

Thank you brother Farook. Personally I find that the problem is not with manpower or with the structure of the syllabus. The problem is without intentions and with the hypocrisy which we find everywhere including in Bangladesh when we try to introduce Islamic economics at the university level. Now I would request one of our brothers well-known in the field of Islamic economics, M. Fahim Khan, to enlighten us on the problems of the syllabus and what we can do about them.

## **M. Fahim Khan**

Thank you, very much, dear brothers and sisters. What has already been said, is very useful and thoughtful. I would at this point like to raise a question related to strategy, namely, how can we introduce an Islamic economics teaching program? Now so far we have been thinking in terms of introducing a separate department of Islamic economics at the university level, but we should give some thought to how far this is going to serve our purposes.

If the department of economics is going to teach economics separately and we are going to add an Islamic economics department, I do not think that we are really going to achieve our objective. Our aim is not to teach Islamic economics as a second subject to be taught at a different level. We want to introduce Islamic economics as a discipline that will change our economic lifestyle, that will affect our economy and that will help us reshape our economy in 'accordance with the economic principles of Islam. Now we should not think of creating an Islamic economics department only for the sake of having a new department with a subject that students take just to pass the degree requirements. When a student goes into the field that subject does not help him in finding a job or in applying what he has learned to the field where he is working.

We need to consider that Islamic economics is not Islamic economics, it is economics; it is our economics. We have an economics department at every university and' Islamic economics should be in that department. It should not be a separate department as a second subject. Economics should be taught as economics having nothing to do with Islamic economics.

So what we should think of is a strategy to include the teaching of Islamic economics as an integral part of the economics course. We have seen the economic growth model taught not as separate economics courses with a separate department. It is a part of the regular economics course and one of the regular subjects. This is a good model for us. Now does Islamic economics have something to learn from this? If Islamic economics has developed certain good ideas and concepts at the practical level, then these should be a part of the economics courses where they belong. If Islamic banking has made certain achievements, then they should be put into the course on money and banking. If fiscal policy and the theory of public finance have been developed in light of Islamic economics, they should be put into the course on public finance. If investment theory and consumer theory are developed, they should go into the

courses on macroeconomics wherever macroeconomics is being taught. This should be one strategy.

Now how can we achieve this? Our goal should be to integrate Islamic economics with economics wherever it is being taught. The second strategy, of course, requires that Islamic economics be further developed. It still has a long way to go to become an independent scientific discipline and to be recognized as economics. An effort has to be made in this direction and that effort cannot be made unless the university takes the responsibility for the development of this discipline. Somewhere within the university, somewhere within the academic circle, a centre of excellence must be created for the development of Islamic economics. It should not be a department in the university, but rather it should be a centre to which all the university continues by providing manpower and resources to make it a centre of excellence for the development of the subject. This centre can develop the subject and collect materials and then the materials can be included in different economics courses.

So what we need to look into is the issue of how to promote Islamic economics in our teaching. This seminar has provided the starting point. A survey of all developments that have so far taken place in the field of Islamic economics, will soon be published as formal proceedings. Similar seminars have been organized in other countries: Islamabad in 1986, Abu Dhabi in 1988, etc. The proceedings of some of those seminars are now available. These materials must be circulated to the departments of economics of all universities along with some guidelines or some insistence on the part of a certain authoritative body to make them an integral part of the teaching of economics. The investment demand theory or the consumer theory that we discussed today should be evaluated from the point of view of whether it is something good to teach in this way. There should be relevant course material and reading material prepared for each course.

Material of a good quality should be developed and should be a part of the course. Similarly, textbooks that are prepared for the undergraduate or intermediate levels should be evaluated by someone at the national, governmental or university level. The different sections of each textbook should be looked into to see if they are appropriate for the intermediate or undergraduate level. That should be the starting point.

The strategy is to make Islamic economics a part of economics and to establish a center of excellence for the study of Islamic economics. Of course

this effort should be made jointly by several universities or by someone teaching economics in a center of economics in a university or even outside of a university but in academic circles. I put forth these suggestions for your discussion. Thank you.

**Chairman:**

Thank you brother, Fahim Khan. I think that there are some very important things that he mentioned. We should agree that Islamic economics be taught in the department of economics because if it is taught in other departments, it will not achieve the purpose. The purpose is to have a knowledge of Islamic economics as a part of what is taught in the department of economics. A suggestion of brother Fahim Khan is that there should be a center of excellence for development of literature and knowledge in Islamic economics for the department concerned.

Another point he made has already been talked about, that is, that the teaching of Islamic economics be started from the lower levels. As for which sections of the textbooks will contain Islamic economics, this can, of course, be decided by persons, who have knowledge of Islamic economics. I think that these three points are very important.

Now I just want to say a few words, not as Chairman but as a participant, about the strategy of how to introduce Islamic economics or make Islamic economics a part of the department of economics.

As our brother M. Fahim Khan told us, it is all a question of economics, not of choosing between Islamic economics and another economics. Economics does not have any color. There are Western universities which are teaching Islamic economics. Yet we are neither implementing nor introducing it ourselves. However, we have all gathered here with good intentions. Take our universities. For example, our universities are states within states. They have complete autonomy and are beyond government control. There is a large body comprising about 130 teachers in Dhaka University called the Academic Council. Any syllabus, any minor change, even one topic, has to be passed through the Council. There are groups within the Council which will campaign among themselves and will be negative if something is said about Islam, not to mention about Islamic economics. Now the Vice Chancellor, the person who presides over the meeting of universities in Bangladesh, does not have any power. He circulates recommendations to the Department of Islamic Studies or Economics suggesting that they try to introduce Islamic economics. With this,

he has finished his duty. His suggestions will not be attended to or if some attempts are made they will be frustrated. This is the problem.

Now I would like to make a suggestion. To introduce Islamic economics at the lower levels would be easier because at the lower levels the government is in control. At the ninth and tenth grades of our high schools, in Bangladesh, if the Ministry of Education sends a note to the textbook board, then they must include a section or chapter or even a book on Islamic economics. This would be easier and I propose that the recommendation committee of this seminar be sent the recommendation that Islamic economics should be introduced at the lower levels and that the government should take the initiative at the first available opportunity.

Secondly, with the studies of business administration, there is no manpower to teach Islamic practices and theories. When we talked about Islamic banking, everyone ridiculed the idea, but now that Islamic banking has come into being, no one ridicules Islamic insurance. People who used to ridicule it are now saying that Islamic insurance may be feasible because we have been successful. These people will do the same thing.

Now we can talk about Islam. The problem is that at the public sector universities in Rajshahi, Jahangirnagar, Dhaka and Chittagong, the problem is more or less the same. There is resistance from those hypocrites who do not want to have Islam at the university. Sometimes they are secularists, sometimes they are socialists and sometimes they are only materialists. They turn to the West for everything and if given money, they will support even Islamic economics, no matter whether they believe in it or not. This type of hypocrisy exists and there are many of them even with Ph.Ds. from the West.

Now I have something to say regarding a strategy to overcome this. I find that many schools in Dhaka are, of course, English-medium schools. In their curricula they have Farsi, the Persian language, which would be unthinkable for a government controlled school to have. No controlled school in Bangladesh teaches in Farsi or Urdu; but private schools do because they are under private management. These private schools have good success rate with many students.

Now we could have a recommendation for a course whether it is in our public or private schools. Our universities in this country are, for a while, finished. No Vice Chancellor can run our universities. Rajshahi closed earlier;

Chittagong is about to be closed or is nonfunctioning and Jahangirnagar is already closed. Other institutions are already closed. So the universities are not functioning. Sometimes I even think that people do not want them to function. Please forgive me for such words. We can have private institutions, private universities in the private sector. If universities are in the private sector, then we can easily convince the administration or owners of the private university to include Islamic economics at the higher level. We can overcome the type of problem that we have been facing for so long in Bangladesh because, unfortunately, although the public wants universities, some people are creating obstacles. So there can be universities in the private sector. We are sending students to India to study at the undergraduate level.

In Pakistan, there are four excellent universities in the private sector. Why not in Bangladesh? We should suggest to our government that this could be a very good way of solving the problems that are being faced by our public universities. Thank you, brothers.

Now I would like to invite comments and suggestions, because this is very important for us. This is the whole purpose of our seminar for the past fifteen days. We are learning by listening or by doing, but the main purpose is to have the teaching of economics from the Islamic point of view at the university level.

#### **Anas Zarqa**

I would like to thank Fahim Khan for pointing out the fact that the real challenge is the introduction of Islamic economics in economics departments. Khan has the added advantage of knowing about the Islamic way of thinking within the field of economics as well as possessing the skill of a standard traditional economist. This is a crucial point and I fully agree with what Fahim Khan has said.

Let me say that the trend towards recognizing an Islamic alternative within economics is already strong and that people who refuse to see this will put up resistance. What we have to do is to make sure we offer something objective and of good quality. In time it will prevail. There are various universities in the Muslim world which have introduced various papers or courses in Islamic economics within their economics departments. This experience can be very beneficial for our efforts. But how do we start here in Bangladesh?



The International Islamic University in Islamabad has already had the experience of teaching several courses in Islamic economics as has the International Islamic University in Malaysia. There is a similar university in Saudi Arabia, but, of course, the teaching there is in Arabic. So the material available is not directly applicable. However, at the universities in Islamabad and Kuala Lumpur, the material is available in English. You may be surprised to learn that there are many very high quality Ph.Ds. in Islamic economics granted by some of the best universities in the world.

Nearly 30 Ph.Ds. in Islamic economics have been approved by top American universities. Their dissertations deal with various aspects of Islamic economics mostly in the financial sector and in money and banking.

Clearly the trend is towards recognizing the Islamic approach to economics as a valid and solid discipline, within the sphere of economics and not stereo economics. It is also for your knowledge, not all of you may know, that a Journal for Research in Islamic Economics is published by King Abdulaziz University's Center for Islamic Economics has been for a number of years listed in the journal economics literature of the American Economic Association because they recognized Islamic economics as a valid discipline. We have simply to explain the necessary approach. This material is accessible and available and changeable for the teachers and the students.

I think that among the suggestions that have been made, the question of translation should have a high priority. Most students in Bangladesh would require translated materials. A specific recommendation in this regard would be most useful from this seminar.

I would also like to emphasize the need for one or two basic courses, in Islamic *Shari'ah* for economists. Material for this is being prepared by the Islamic Development Bank. The IDB's *Fiqh* committee has done some work in this direction and is making material about the *Shari'ah* available to economists. *InshAllah* this helpful material is on the way, but until it becomes available we should not think about introducing Islamic economics unless we have a *Shari'ah* course. We can have a better and deeper understanding of Islamic economics when we have more knowledge of the *Shari'ah*. However, even with the knowledge available to the average Muslim about the *Shari'ah*, you can learn a great deal about the Islamic economic system. So we should not make one move contingent or dependent on another.

Finally, I have one other point to make. We must make sure that whatever we suggest regarding the teaching of Islamic economics that students will graduate with marketable skills. We should avoid anything that would prevent a student who acquired this knowledge from earning a decent living. So whatever we design, we have to make sure they graduate with some skill that society needs. In some countries it so happens that when students choose Islamic economics, businessmen think that graduates of these departments do not know economics. Now this is a crucial consideration. So it may be more sensible not to insist on calling it a department of Islamic economics. Let economics be taught but with a good Islamic basis in addition to the basic skills of economics.

With this I conclude and suggest that probably after the seminar we can sit together and draft an outline of an action plan regarding the developing of curricula for establishing the discipline of Islamic economics.

### **The Chairman**

Now I invite comments and contributions from our brothers and sisters on the floor.

### **Comments**

Thank you Mr. Chairman for opening the discussion in this session. I would like to add my views to what has been said so far by the different speakers. Teaching Islamic economics at the university level is far from a reality and will remain so until Islamic economics is introduced from the primary level in Bangladesh. In Bangladesh there are different levels of teaching: the primary level, the graduate level and the postgraduate level. Islamic economics is taught in none of these levels. Therefore, it is absolutely impossible to teach Islamic economics at the university level or to establish a department of Islamic economics in colleges or universities. So my suggestion is that Islamic economics should be taught from the college and intermediate levels as well as from the university level.

There are departments in colleges where honors courses are being taught. In each college and in each department, Islamic economics should be introduced at least as a paper. Yet, I believe that what the Chairman said a few minutes earlier is very pragmatic. If we are sincere and really concerned, we should start a school, college or university under private management. These

schools, colleges and universities should be run and financed by the Muslim countries of the world. If they come forward and if schools and colleges in different Muslim countries are established, then we can introduce Islamic economics from the grass roots. Bangladeshis do not know Arabic. We are a Bengali-speaking people. At the primary level, the Arabic language should be compulsory. With perhaps some courses in Islamic economics. However, from the intermediate level, Islamic economics should be taught either as a paper or an alternative paper. From the university level, it should be taught like this. I believe that if we have a sincere desire, then we can implement our objectives. We can establish a school or college under private management and Islamic economics in a university in Bangladesh in particular or in another country.

### **Abdur Rahman**

I think what the brothers said, about how to introduce Islamic economics is very fine in and of itself. If we introduce separate Islamic economics departments especially in Bangladesh we will face a half of a problem in the process, and we want to see it done. However, I think that there is no objection to the introduction of new courses and electives in the existing departments of economics. It is easy to introduce Islamic economics. You can argue that since we have the right to introduce socialist economics on the principle that it is an elective, by the same token we should be able to introduce Islamic economics as elective courses at the university level or at the graduate level. You can introduce elective courses step by step and later specialization will be possible. People who want to specialize in Islamic economics can take these courses. In this way students will be able to graduate from an economics department with a specialization in Islamic economics.

### **Chairman**

Thank you, brother Abdur Rahim. It is a very good suggestion to have an elective option for those who want it. Unfortunately, there are many people in the body responsible for casting votes to determine what will or will not be an elective subject. Some of these people may not see the problem as we do. It is common sense that if socialism is an elective then many other disciplines should also be offered as electives. No one should be opposed to this. Unfortunately, the truth of the matter may be otherwise.

## Shah Habibur Rahman

Thank you, Mr. Chairman. I would like to make some points relating to this subject because I have been a victim of such opposition. After 1971, one of the teachers introduced socialism by force. He designed the course and asked the committee to introduce it. Ten years later when I proposed a course on Islamic economics, it was circulated among the members of the faculty and some art students from Dhaka and Rajshahi opposed it. They said that when you people get ideas from Saudi Arabia, then will you propose it to be introduced there. So brother Abu Ahmed and others have had a similar experience.

The problem is these "other people". Many of you know that Islam is a complete code of life. But I think more or less there are people who don't believe in that, and do not practice it in real life. My one suggestion is to make a start. Our people should be aware of the demands and norms of Islam which will not happen unless they are fully aware of Islamic life. However, as brother Zarqa told us, there are no job opportunities for the students who are trained in economics, then naturally there will be little demand for the subject. A public demand for this subject must be created. Lectures should be given in order to orient people to this subject and *Ulemas* and other learned people should talk about Islamic economics in public, so that people become aware of the necessity for it. If this is done, then the introduction of the subject will be easy.

My second suggestion is that Arabic should be learned by scholars of Islamic economics.

If you want to know the *Shari'ah* from the text and if you want to learn about the research work currently undertaken in Saudi Arabia and other countries, you must know Arabic well. However, this is not a must for all teachers. There should be some teachers who are asked to join the Centre for Research of Islamic Economics in Jeddah to go to Jordan or other Arab countries in order to learn Arabic quickly. There should be some special arrangements for teachers who will learn Arabic and will teach economics.

My third suggestion concerns private organizations in Bangladesh working for the dissemination of Islamic economics, for example, Islamic Economics Research Bureau. This Bureau has been functioning for more than a decade. It has organized a large number of seminars and published a large number of books, and it also currently publishes a journal. They may be able to help the government universities because, as far as I know Islamic economics

was taught by this bureau before. This research bureau organized two large seminars: the first on Islamic economics and the second on banking. They have published the proceedings of these seminars and many Bengali books translated from books in English. They are also currently publishing a journal. This bureau could also establish some divisional branches or other organizations as brother Abdul Rahim has proposed. There could be a divisional or district research organization for Islamic economics established along with other institutions. The IDB or perhaps the IAIB could help these organizations by providing books and journals along with some financial help. Do not think that there is much hope in government policies and promises.

There is a Bangla Academy which is responsible for translating and publishing books. However, if you submit a book to the Bangla Academy for publication, it will take at least three to four years unless you are someone whom they like in which case your book might be published in three weeks time. Therefore, I think for the publication of books translated into Bengali, a private organization should be asked to submit concrete proposals. Thank you very much, Mr. Chairman.

### **Chairman**

Thank you, brother Habibur Rahman. I think that it is very important that the private sector bureau receives some money as they can perform their functions much better than the government. The IDB gives money to our government for this purpose, but I think that government institutions are not in a position to use that money purposefully. It would be a very good idea if the IDB could do something about this. I would like to add that the International Institute of Islamic Economics at Islamabad is a very fine institution. They have many books, but they do not have many scholars. When the Indian Government can give six or seven hundred scholarships to Bangladesh, why is it not possible for the Institute in Islamabad to give 50 scholarship to Muslim boys who want to study Islamic economics there? I do not find this logical at all. Our students need a greater opportunity to study Islamic economics. It does not matter whether they get their degrees in Ph.D. from an Islamic university. They will be very valuable here in Bangladesh, no matter where it is from. This is my humble suggestion.

**Fahim**

The Chairman has referred to the International Islamic University at Islamabad, and it so happens that I was the director of the School of Economics of the University about three years ago. Your point that the International Islamic University should have policies for students from abroad is very appropriate. You do not perhaps know that all foreign students at the International Islamic University are invariably given scholarships. We do not really refuse applications from Bangladesh for admission to the University. Although I am not at present connected with the University, I know their policy. Please send your candidates. If they are good candidates they will be selected on merit, and those who are selected will be given scholarships.

**Chairman**

Thank you brother. We did not know about this. From now on think a circular should be circulated among our universities or institutions informing people that scholarships are available at Islamabad University because that is very important for Bangladeshi students.

**Sirajul Haq**

At the Islamic University of Bangladesh, we have a course at the honor's level which is called Islamic economics, but it is optional and the premises that no one is offered to teach it and we do not have enough reading materials. It is in the MA final year. Islamic thought, as a topic, called Islamic thought on economics, is placed at the premises in Chittagong University. No one offers this course. Perhaps when I go back, I will try to offer the course. I request enough materials to enable me to do so.

**Chairman**

Thank you, brother. I want to make one suggestion. The trend in modern economics methods in fiscal policy, and monetary policy. However, for the sake of our faith, let us give those subjects to other brothers and take up the subject of Islamic economics. Let it be started at whatever level because once we start then other people will follow in three or four years' time. Suppose that you are teaching mathematics or fiscal policy and there are many other people available in the department who can teach that. In my department, I have said many times

that if they want me to teach Islamic economics, I will make myself available. However, I will not teach quantitative methods, and I will not teach monetary economics because there are many others who can teach these subjects. So I want to serve my faith at least partially. Thank you.

### **Anas Zarqa**

The discussion points out that one way to promote Islamic economics and to make its implementation feasible is to have some people who are reasonably knowledgeable about it. I would like to call attention to one program which has been initiated by the Centre for Research in Islamic Economics. It is available to any graduate student anywhere in the world. It is a program of scholarships for Ph.D. dissertations about Islamic economics, that is, any Ph.D. students registered in any university in the world for a dissertation within the purview of Islamic economics can receive scholarship support. This particular dissertation or research announcement will, *InshAllah*, reach you soon. It has already been prepared for circulation. This may, I think, even be accepted by teachers who may not be terribly keen to introduce Islamic economics but who would not like if one of their students is doing his Ph.D. dissertation in the subject. So if we try to *InshAllah* circulate this announcement then some of the students will through the preparation of dissertations become reasonably competent in Islamic economics, and they will be the teachers and researchers of the future.

### **Chairman**

Brother Anas Zarqa has told us that there are opportunities to receive scholarships to any of the universities in the world, whether in Bangladesh or the United States. If someone in higher education is somewhat afraid to get involved with Islamic economics, this would be very good thing to be known. This information should be disseminated to our brothers around the world.

I think this is very, very important. Let our brothers do their Ph.Ds. in Islamic economics and then later they will be eager to introduce it at the university.

### **Sulaiman Mondal**

Thank you very much for giving me the chance to speak. I agree that there are problems in introducing Islamic economics at the university and

college levels. University and college courses are designed by the committee of course study in departments everywhere in Bangladesh. The course is prepared by the department and then if it is approved, it is forwarded to the relevant faculty. If the faculty approves, then it goes to the academic council and if the academic council approves, it then becomes a part of the syllabus. This is a procedural matter.

I do not think that the shortage of books is a fundamental obstacle to teaching Islamic economics at the university and college level. This is a surmountable difficulty, and at present the environment is not very hostile to the teaching of Islamic economics. Previously there was a lot of hostility. It is like when the economics of socialism was introduced in Bangladesh as one of the fundamental principles of state policy, as socialism was one of the pillars of state policy. Therefore, socialism was taught as a matter of necessity from the point of view of the condition of Bangladesh. Nowadays, it is highly surprising that the economics of socialism is still being taught in this country. Now the socialism is on its way out, what value is in replanting it in this country, especially that socialism is no longer a field of thinking at least among the members of the public. Therefore, the environment is quite congenial for the teaching of Islamic economics. However, the environment at the university level has not changed substantially. I would not say that this environment has not changed at all, because we have at least been able to introduce Islamic economics as a part of secular economics where we have been teaching the history of Islamic thought at the MA final level. We have also been teaching banking and *Zakah* at the honor's level.

Therefore, I would not say that we have not been doing anything, but the major obstacle is the members of the department. First of all they have to be motivated so that they become convinced of the necessity of teaching Islamic economics. I think that accessible good quality material is a good way of convincing them that there is a viable Islamic economic system. People trained in the secular line do not have the courage of resisting Islamic economics directly. They say that they do not have materials available as they do in secular economics. Therefore, I would suggest that good quality materials be made available to the different departments of universities and then they can be convinced that standard materials are available in Islamic economics. We can hold seminars on Islamic economics at various departments of the universities and that will serve as an eye-opener.



I think, those who oppose it, are human beings, they can at least modify their temper to some extent if they find that there is a viable system existing in Islamic economics. This can be a way of stopping them from becoming very aggressive with regard to complaining about Islamic economics.

In the context of Bangladesh, I think it is best to introduce Islamic economics at the Islamic University located at Shantidanga, Kustia. This is an Islamic university, and therefore, there should not be any obstacles to introducing Islamic economics at the honor's level as well as at the postgraduate level. I do not have any access to the syllabus that has been prepared for the university. Perhaps before we make any recommendations we can gain access to that syllabus so that we can examine it. Possibly we can recommend the standardization of the syllabus. We have been trying our best to incorporate materials related to Islamic economics within the secular syllabus, as Fahim has pointed out. I agree that this is the proper method of teaching Islamic economics. It should be a part of secular economics. I think that this should be the correct strategy.

As regards manpower, we need competent people to teach Islamic economics and I think that this kind of conference or seminar should be held more regularly so that people trained in the secular line can be oriented towards Islamic economics and can very easily learn Islamic economics because more or less the same technique is applied to learning Islamic economics and the same methods are applied to teaching it. Therefore, those who are willing to learn Islamic economics can always do it.

This session on Islamic economics has been very useful. As for myself, I have not attended any conference on Islamic economics although I know a lot about the subject. I think that the Islamic Foundation should invite more and more people to participate in this kind of seminar, so that more and more people trained in secular economics can be taught Islamic economics. In this way the shortage of trained people will gradually diminish. I think by this time a lot of materials are available in English. These can be translated into Bengali, because in this country, as a result of Bengali nationalism, we have switched over to Bengali as a medium of instruction. This has been rather unfortunate for education in this country, because people have been educated mainly for the domestic market. However, if people are trained through the medium of English along with an orientation in Bengali, they will be able to find jobs not only in Bangladesh but also in other countries. Therefore, perhaps we can encourage more people. I also very much welcome the idea announced by Zarqa. We did

not really know that some facilities are available for scholars to undertake research. If such facilities are available, I think scholars will be willing to come within the fold of Islamic economics because, after all, material benefit counts for something. As you can see socialism is on the decline because people do not benefit materially from it. Therefore, they are now giving up socialism.

Another important point, brothers, is that there should be publicity given to seminars such as this one. We have been here for ten or eleven days. There are many learned scholars who have come from abroad and excellent papers have been delivered. Yet despite the fact that this is a very distinguished seminar there are no media representatives here. Many of our newspapermen write stories everyday, but no news has been written about what we are doing here. Perhaps the organizers have another strategy.

Perhaps it is thought that since this workshop is of a rigorous type, the media should not be involved. I do not know. If the organizers have thought this way then I beg to differ with them because there are three or four Islamic newspapers in the country now which would have been pleased to report on this seminar. But they have not been told to come here and there is no news on television.

I would like to address the question of the syllabus and reading materials. Many of the brothers have asked what the Islamic Economics Research Bureau has been doing for twelve years at the private level. During this time the syllabus committee has drafted a syllabus for the intermediate and graduate levels. Ali Ahmed Rushdi was the Chairman but he is now in Australia. The group has collected syllabi from various universities of the world of Islamic economics and has sent out a draft copy to distinguished scholars of different universities for their opinion. Later this will be circulated to universities in this country and abroad. I think that those brothers who think that nothing has been done are not correct. We have been working for Islamic economics for a long time and we have progressed. Brothers, I would like to inform you that the Islamic Economic Research Bureau (IERB) has published a number of books, journals and quarterly journals.

We have already translated books on Islamic economics and banking. Mannan's Islamic Economics: Theory and Practice has already been translated to Bengali and circulated as has a book of money and banking by Omar Chapra. We are currently translating two books: Muslim Economics Thinking and Towards a Just Monetary System. These books will be coming out very soon in

Bengali and we have already published books and journals on the Islamic approach to development based on our international seminar on that topic.

We have also published special papers on the distribution of wealth in the Islamic system and on Islamic insurance based on a special seminar on the subject. Now the good news is that an Islamic insurance company is going to open in the country under the Guidance of the IERB. Another book on Islamic banking has been published by the IBBL at the university and graduate levels. So I think regarding the syllabus, that the IERB is doing a lot and as for materials, we have already done a lot. I think that the brothers here can help at the private and governmental levels.

I think one point that needs to be made is that political commitment is necessary for establishing a new system. In our country at one time the government ordered the introduction of socialism at the university level and all universities complied. If the government ordered the introduction of Islamic economics at all levels that would also be done. So I would like to request the organizers to include the recommendation that the government order school boards to introduce Islamic economics at the school, college, intermediate and university levels and to introduce Islamic economics as a part of general economics at the graduate, honor's and master's degree levels.

#### **Another Participant**

The important point is that the government should order, not request, for a request will not be attended to.

Secondly, a point was made by brother Tajul Islam regarding the performance of the IERB. I think that there is a lot that they have done, but the problem is one of funding and finance. They lack funds, and, therefore they cannot offer a good remuneration to translators. Once they approached me to do some transaction. I asked how much money they would be offering and they said that they only had an honorarium. That is the problem. They should be funded either directly by the government or indirectly by having their literature purchased by funding authorities and distributed among the brothers here or in some other way feasible to the prospective supplier of funds. Thank you.

**Zahurul Islam**

Thank you Mr. Chairman. So many people have spoken on the implementation of the curriculum that I doubt that anything substantial can be added. However, one further point is that specialists should help to prepare the curricula. I point this out as someone who has worked for a long time in government service. We find that graduate's and master's degree holders after leaving the university join government service or corporate bodies and are not able to attend to the needs of the administration. As a result much time is wasted in training them for their assigned job.

Naturally, the question arises of the defectiveness of courses offered in the university. Therefore, something should be included in the design of the curriculum in order to solve this problem. Islamic economics, Islamic management and administrative requirements of the country should be carefully examined and then included in the syllabus. so that after having graduated, these young people can assume their new assignment and do the job successfully.

Another important point is the question of job opportunity. If an Islamic economics course alone is offered at the university level, no one is taking it. If courses on law, management or accounting can be added to the syllabus, perhaps this will provide a better opportunity of getting a job. At the university there are courses in the accounting, management, economics and legal department which are now very relevant to the work going on in different corporate bodies. I request that specialists be involved in drawing up the syllabus of Islamic economics courses at the university level. Thank you.

**Chairman**

Thank you brother Zahurul Islam. I think that it is important that the economics department should not be the only department where we can address this problem. The finance, management and accounting departments also teach economics and some of them may be much more willing to accept Islamic economics as a part of their syllabus. So I think that our recommendations should also be addressed to those departments. So it is a good point that if Islamic economics is not taught in the economics department, it can alternatively be taught in the ' finance, management, accounting or business studies departments.

**Brother Rahim**

I would like some information about the Center of Association for Islamic Economics which financially supports potential researches who are writing about topics related to Islamic economics or developing an Islamic curriculum. I understand that financial support for research is in the range of 30 to 60 thousand taka for each research project. Is this opportunity open to everyone?

**Chairman**

Thank you, brother. I personally know about that opportunity. Unfortunately, the problem is that some of us do not know Arabic. We know, however, that there are many offers secular economics. One of the problems is that we do not get the 50 or 60 thousand taka most of the time because we do not finish the research. At any rate, brothers, there are opportunities available and these opportunities should increase if the money is raised. Locally the, N.G.O. is offering one or two lakhs which is, of course, coming from Western sources. So these issues can be raised, I think, and if we cannot blend a knowledge of Arabic with economic then you can forget that part when you consider persons from Bangladesh. Thank you.

**Anas Zarqa**

The Center's greatest obligation is to research in Arabic or English. However, the Center in principle can accept research in any language, but the two most widely used working languages in Islamic economics are Arabic and English. Some are also written in French. However in principle there is nothing to prevent the Center from accepting research in any language.

**Chairman**

Thank you, brother. When I was talking about a lack of knowledge, I was not necessarily talking about the problem of English. Once I have chosen a research topic, such as the land management problem in Islam or land ownership patterns, I do not know the *Shari'ah* background. However, I do know the modern economics system and how they handle these problems in many countries. When I rush to the Arabic or the Islamic economics department to ask the brothers there about *Shari'ah* verdicts or a specific *Aya* or *Hadit*, I find that,

unfortunately, they are ignorant about it and cannot guide me. So I have given up that type of thing.

**Anas Zarqa**

One thing we should seriously try to do is to combine in some way the efforts of the economics scholar and the *Shari'ah* scholar. This will be something that has not been tried for a long time in the Center, because we rarely received a proposal for combined research. Most of the proposal received are from individual persons. To overcome this we need a *Shari'ah* scholar and an economics scholar to work together to cooperate in writing a paper.

Another point that the Chairman made is in regard to the honorarium. An honorarium of 15, 30, or even 50 thousand taka is not a really good amount for good research. Mr. Chairman. Western agencies pay much, much more than what organization in the Muslim world pay for research. This is a point I think we should recognize. I have also noted, and it was taken as a recommendation, that if we really want to conduct research, the organization should make it respectable for people to do research. It should not be left to the commitment of people to do research by sacrificing the opportunities that they have to do research in other fields. Thank you.

**M. Fahim Khan**

Yes, brother, thank you very much for briefly describing the program that the brother has mentioned. We have in IDB/IRTI a program which is called the encouragement and promotion of Research in Islamic Economics. There are, in fact, two programs: One is an external research program in which we ask scholars to do research for us on a topic selected by us; the other is an Encouragement and Promotion Program. We are looking for people who are doing research on their own in the field of Islamic economics who need some help. So this is the second program that the brother is talking about. We circulated the information that we are here to help brothers in implementing their own research in this field. If you are doing some research, then please be aware that you can be in this. This program was circulated to university departments. The brother is very optimistic in thinking that we must have received a lot of responses. In fact, I must tell the brother that we did not receive any response. So, anyone who is interested in this program should inform us that he is doing research in such and such an area and describe his problems. We would like to help. Thank you.

**Chairman**

Thank you, brother M. Fahim Khan, and I request Fahim Khan to view these proposals with a liberal attitude because when we submit something, a lack of knowledge of the *Shari'ah* is a handicap. so you cannot expect a very rigorous proposals from Bangladesh or other countries in the eastern part of the world. Therefore, a liberal attitude should be taken. There was a proposal sent by the University Grants Commission (UGC) about research in Islamic banking in Bangladesh by some brother and some institution. It was not very rigorous, but still we have recommended it because it is related to Islamic banking. We felt that there should at least be some research. So this is the type of attitude which I think would be very much welcomed by us.

**Another Participant:**

Thank you, brother. I would like to request the Chairman to arrange that the concluding session be chaired by a personality in the Government of Bangladesh so that we can address all of these things. Thank you.

**Chairman**

Yes that is a good suggestion and I will refer it to the organizers. If we bring someone important we can make a lot of very fine speeches, but the problem is that none of what we say is to be published. This is our problem. We should have invited the media here; at least some representatives of the media should have been here.

Brothers, one more announcement. We have only two days left to finalize our recommendations. We must make our final suggestions today, so that we can shape them for final publication and circulation.

Thank you, brothers for the discussion and our brothers M. Fahim Khan and Anas Al Zarqa for giving us very valuable suggestions and for enlightening us. With this I conclude this discussion. *Allah Hafez.*

**APPENDICES**

**OPENING AND CLOSING  
SPEECHES AND  
RECOMMENDATIONS**



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**SPEECH OF THE STATE MINISTER  
FOR THE RELIGIOUS AFFAIRS OF  
THE PEOPLE'S REPUBLIC OF BANGLADESH**

**On the Occasion of the International Seminar  
on "Teaching Islamic Economics At University Level",  
Held From July 23 to August 5, 1991  
*Alhaj Professor M.A. Mannan***

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Respected Chief guest, Begum Khaleda Zia, Hon'ble Prime Minister of the Government of the People's Republic of Bangladesh, Hon'ble Speaker of the Parliament Abdur Rahman Biswas, Respected Ministers, Members of Foreign Embassies in Bangladesh, other guests and participants.

*Assalamu Alaikum,*

I feel myself fortunate enough and express my deep gratitude to Almighty Allah as I could attend this long desired Seminar organized jointly by the Government of Bangladesh and Islamic Research and Training Institute of the Islamic Development Bank, Jeddah, Saudi Arabia.

I strongly believe that this Seminar jointly sponsored by the Islamic Research and Training Institute of the Islamic Development Bank, Jeddah, Saudi Arabia, Islamic Foundation Bangladesh and Al-Baraka Bank Bangladesh Ltd. on the "Teaching Islamic Economics at University Level" being held in Dhaka, will undoubtedly create a new dimension in the glorious Islamic heritage and religious belief and as well as in the field of higher education in Bangladesh.

The irresistible tide of golden age of Islam flooded all the directions since the first half of the 8th century the wave of which touched the regions of Sandvip and Chittagong situated in the Eastern outskirts of Bangladesh. The Hermits and *Awlia* came here with selfishlessness and empty handed with the Arab traders. Muslim inhabitation and educational institutions such as mosques and hermitages were developed by them.

The history since that period is the history of continuous preaching of Islam, its principles of equality, justice and mutual love and affection, taking shelter of people and priests of different religions under the fold of Islam.

The march of Islamic education that started from the mosques and hermits of *Awlia* reached in its ripeness now. Under these circumstances, this seminar is being held in the capital city of Dhaka which may be considered as a special bounty of *Rabbul Alameen*.

### **Hon'ble Guests,**

The history of economic activities of these socially organized men is as ancient as the history of mankind. Yet the theorized basic principles of Economics are comparatively new. The laissez-faire theory of Adam Smith came out with the declaration of basic stairs of progress and enrichment resultant of which is the uncontrolled private initiatives, profiteering and the competition without any government control. This was the outcome of European Renaissance, internal conflict of Christianity, discovery of new lands; infiltration of Europeans in the Latin America, Africa and Asia and establishment of their Empires, Industrial revolution of Europe and expansion of international trade.

Today it is not necessary to explain that this concept of free economy at one stage had to remain standstill. Adam Smith and his followers had forgotten that progress and enrichment achieved by the Western Nations due to free-economy - the reason of which is not more personal than that of imperialist exploitation and boundless profiteering intention. The so-called free economy converted the defeated nations into exporters of raw materials and importers of industrial goods by destructing their wealth and property. This heinous efforts made the imperialist countries rich. But as a result of the first World War economic depression attacked the whole world and later on freedom of nations from the yoke of colonialism proved that the progress of free economy is not unbridled and sky-high. This laissez-faire or limitless free economic system could not bring any permanent welfare for the greater section of the people.

At the backlog of failures of laissez-faire economy the socialism came up with a new doctrine of salvation. Due to polarization in the field of economics, the developing nations have been sorely wounded. Thus, developing countries have become poorer and shouldering debts of thousands of millions of dollars and made their next generation under the bondage of debts because of

their continuous fascination for different 'ism' keeping aside their own wealth and technology.

The millions of people are being sorely wounded due to hauling up of different economic doctrines and development strategies. Unfortunately, though such an unwanted situation is prevailing, yet the western scholars do not find scope to look at the ever permanent framework of Islamic economic system and the basic directions envisaged by the Prophet (Sm.) of Islam and Al-Qur'an, descended in the Seventh Century. Though there is economic system and development strategy within the frame of Islam which is more welfare oriented for the people of all strata than the so-called laissez-faire economics and socialism, unfortunately, it is observed that there is a trend of avoidance of this ideal system of economy on various pleas - such as reactionary and re-advent of Mediterranean religious madness, etc.

### **Scholars Present**

Economics is basically a science of wealth. As wealth is required for the welfare of mankind, likewise unequitable distribution of wealth spreads disparity, conflict and maldistribution in the society. Islam has provided a unique principle in respect of utilization of property and its dissemination. This helps diminish the gap between the rich and the poor by the financial arrangements of *Baitul Maal*, Poor-tax, *Fitra* and sacrifice of animals. Not only that, due to Belief in the Creator, we forget the difference between man and man. To keep control over pride, we use to perform *Salat*, *Saum* and Hajj, etc. which help reduce the disparity between the rich and the poor. In Al-Qur'an, with the instruction for performance of *Salat*, there is simultaneous instruction for the payment of poor-tax (*zakah*). So, Islam not only has given importance on the proper distribution of property but also emphasizes on the promotion of human character which in the real sense of the term a welfare code for the mankind.

I am not an economist. You, the people present here and the participants of the seminar undoubtedly are much more knowledgeable, experienced. I am sure that openhearted discussion and research are the only means of uncovering the way of salvation and redemption of poverty of human being. So, we see that the first verse of Al Qur'an descended with the call to read. There is also a clarion call of Prophet Muhammad (Sm.) to acquire knowledge. As we believe that the message of Al-Qur'an and the ideology of the Great Prophet Muhammad (Sm.) is considered and believed as a universal truth and welfare

oriented. So it is inevitable, with a view to establish an economic system to launch analytical discussion of Islamic Economics, for its flourishing, research and application through which the new strategy of development process with critical examination will come up.

It is not enough to keep this proposal of research and analysis of Islamic economics within the framework of speech, seminar or publication of articles in the papers. For this, introduction of institutional education is must. It may be possible only through taking steps for introduction of Islamic economics and research program at the university as well as college levels. Through this method of action, deeper exercise of Islamic economics and its application may be flourished through such methods.

### **Gentlemen**

The seminar inaugurated today bears importance from different considerations. Through this, a good start of study Islamic economics and research have begun. The study of Islamic economics at university level will bring out practical strategy for socio-economic development of the Muslim world. As a result, a social system will emerge which will help reduce the disparity between the rich and the poor, establish a sense of mutual sympathy and humanity which will bring happiness and welfare for the Muslims in particular and the mankind in general. This will also cease to an end of hatredness and mutual quarrels.

Finally, I pray to Allah for the success of this seminar in totality and I end my speech once again by extending my respectful thanks to the Hon'ble Prime Minister and the personalities present here.

I also convey my good wishes to the sponsors and all concerned related with the seminar.

Allah Hafez  
Bangladesh Zindabad  
The Unity of Islamic World Zindabad

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## CONCLUDING REMARKS

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### **The Chairman**

H.E. the Minister of Religious Affairs of Bangladesh

*Assalamu Alaikum Warahmatullah*

Brothers and sisters, this is the end of our seminar. I conclude the seminar so if anything was wrong, it was my fault and if anything was good, then give praise to Allah, and I call on the Director General of the Islamic Foundation to give his talk.

### **Concluding Address by Janab Mansurul Haque Khan of Islamic Foundation**

*Bismi Allah al Rahman al Rahim.* Honorable special guest, Excellencies, distinguished participants, gentlemen. *Asslamualaikum Warahamatullah Wabarakatuh.* Praise to the Almighty Allah who has infinite grace to enable us to organize and successfully complete today the first ever international seminar on Teaching Islamic Economics at the University Level in Dhaka. On behalf of the Islamic Foundation, I express gratitude to the chief guest who was unable to be here due to circumstances beyond his control. I welcome the special guest of this function, the Hon'ble Minister of State in Charge of the Ministry of Religious Affairs, Alhaj Professor M. A. Mannan, without whose interest and initiative, it would not have been possible to organize this seminar. We are especially thankful to the Secretary of the Ministry of Education, Janab A.S.M. Eusuf, who has kindly taken the chair at this function and we also express thanks to the Secretary of the Ministry of Religious Affairs, Janab A.Z.M. Shamsul Alam, whose personal contribution and initiative have greatly contributed to the success of the seminar.

Today the international seminar on the Teaching of Islamic Economics at the University Level has come to an end. On the opening day we expressed the hope that the seminar would open the door to a new strategy for economic development based on the Islamic principles of justice, moderation and fairplay. The distinguished scholars from Bangladesh and abroad have participated in the

seminar and have made extensive recommendations on the need for and method of teaching Islamic economics at the highest level of education.

We are today richly reassured by the hope expressed earlier. We sincerely believe and earnestly hope that the contributions made at this international seminar will go down in our history as a pioneering efforts. I express our thanks and gratitude to the distinguished participants and scholars who have contributed so much in this unexploited field on this occasion. I also express my sincere thanks and appreciation for the contribution made by the Islamic Research and Training Institute of the Islamic Development Bank, Jeddah, as the sponsor of this seminar in Bangladesh. Its contribution is unique in the field of the research of Islamic subjects and also in its organization of such seminars and workshops. I extend thanks to your excellency, the Hon'ble representative of the Islamic Research and Training Institute, M. Fahim Khan, for the initiative and the leading role that you have played in organizing this seminar. I thank you on behalf of the Islamic Foundation and on the part of the People's Republic of Bangladesh. I take this opportunity to express our thanks and gratitude to the local financial institution, namely, Al-Baraka Bank Bangladesh Ltd., Islami Bank Bangladesh, Sonali Bank, and others, who have extended their helping hands and active cooperation to make this seminar a success. Finally, I invoke Allah's mercies on our Prophet (Pbuh) and I want again to welcome you all and pray to Allah bestow His blessings to all who directly or indirectly contributed to the success of the seminar.

### **The Chairman**

Thank you all. Now I would like to request M. Fahim Khan, Head of the Research Division, IRTI, Islamic Development Bank, Jeddah to kindly deliver his speech.

### **Concluding Address by Head of Research Division, IRTI, M. Fahim Khan**

Your Excellency, the Honorable Minister of State for Religious Affairs, Alhaj Professor M.A. Mannan Shaheb, Secretary of the Ministry of Education, Janab A.N.M. Eusuf Shaheb, Secretary of the Ministry of Religious Affairs and Director General, Islamic Foundation of Bangladesh. It is an honor for me to address you today on behalf of the Islamic Research and Training Institute of the Islamic Development Bank, Jeddah, on the occasion of the concluding

session of this seminar, organized and cosponsored by the Islamic Foundation of Bangladesh and Al-Baraka Bank of Bangladesh.

The Islamic Research and Training Institute of the Islamic Development Bank aims at conducting research and training in the field of Islamic economics, banking and finance in order to help member countries that are in the process of Islamizing such activities in their economies. The need for research and training in the field of Islamic economics has increased recently in view of the growing interest in Islamic economics and Islamic banks. You may be aware that there are around one hundred Islamic banks with more than one thousand branches operating in various parts of the world including the Western World.

Two countries have fully Islamized their banking system and others are in the process of further improving the Islamization process. Sudan is a country which already has a record of successful operation of an Islamic bank offering a large number of economic activities, and there are efforts to further expand the Islamization of the economy. Moreover, there are several universities in the Muslim World which have specific faculties and centers conducting research on Islamic economics.

This growing interest has also forced academic institutions in the Western World to pay attention to the study of this new discipline. Dozens of Ph.D. theses and master's level theses are being written in the economics and finance departments of universities in the United States and the United Kingdom. Universities in other parts of Europe are seriously considering introducing degree programs in Islamic economics in their economics and finance faculties. As a result there is a heavy demand for research and training in various aspects of Islamic economics and banking.

The Islamic Research and Training Institute of the Islamic Development Bank is making efforts in this direction by conducting research within the IRTI by mobilizing researchers outside the institute to do research, by organizing seminars in various parts of the world and by collaborating with various institutions in the Muslim and non-Muslim World in various schemes that aim at promoting research and training in Islamic economics. This seminar is one of our various activities in which we aim at creating awareness among interested people about the material available in the field of Islamic economics. This seminar has particularly focused on creating awareness among scholars who are associated with the teaching of economics at the university level.

We hold international seminars in different countries and invite university teachers and scholars as participants to attend. We invite renowned scholars of Islamic economics to speak on the academic development on various aspects of Islamic economics.

This year we chose Dhaka to hold this seminar, and we are grateful to the Government of Bangladesh and the Ministry of Religious Affairs who have provided the opportunity to hold this seminar in cooperation with the Islamic Foundation of Bangladesh. This seminar has concluded today and I must admit that the cooperation of the Islamic Foundation of Bangladesh has been instrumental in making this seminar a success. Ten participants came from eight different countries to attend the seminar. Seventeen participants came from various universities of Bangladesh as official delegates and another ten also attended. Scholars of international renown came from abroad as well as from within Bangladesh to deliver lectures in this seminar. Scholars who delivered lectures include renowned scholars, such as, M. Omar Chapra and Anas Al-Zarka. I must say that the interest and enthusiasm shown by all the participants has been extremely impressive: The level of participation was not only of a very high quality but was also very deep, reflecting their attachment and commitment to learning. I am sure this seminar has motivated the participants enough to go back and see how they can incorporate the development in the field of Islamic economics into their own courses on economics in their respective universities.

. The motivation and inspiration acquired in the seminar is also reflected in the recommendations that the participants have made which relates to teaching and research in Islamic economics. On behalf of the Islamic Research and Training Institute and the Islamic Development Bank, I thank the cosponsors of the seminar, namely, the Islamic Foundation of Bangladesh, Al-Baraka and the Islami Bank. The cosponsorship of Al-Baraka Bank has been instrumental in the organization of this seminar. I must express my heartfelt gratitude to the staff of the Islamic Foundation of Bangladesh who have worked untiringly day and night to make the arrangements for this seminar. I must express my gratitude to all of those who have directly or indirectly been associated in making this seminar a success. I end my words here with *a Doa* that Allah *Subhanahu Ta'la* give us all the strength and courage to continue to serve His cause the best possible way and we look forward to future opportunities in Bangladesh to organize similar activities. Thank you, very much.



## **The Chairman**

Now a word of thanks by Br. A.Z.M. Shamsul Alam, Secretary, Ministry of Religious Affairs.

### **Speech of A. Z. M. Shamsul Alam, Secretary of Ministry of Religious Affairs**

*Bismillahi al Rahman al Rahim.* Mr. Chairman of this concluding session of the seminar on the Teaching of Islamic Economics at the University Level and the chief guest of this concluding session, the Hon'ble Religious Affairs Minister, Professor M.A. Mannan, M. Fahim Khan, the distinguished representative from the Islamic Development Bank, the Director General of the Islamic Foundation, distinguished guests from brotherly Muslim countries and guests from Bangladesh. Assalamualaikum.

My job has been simplified by the Chairman of this seminar and also by M. Fahim Khan. They have already conveyed the vote of thanks on behalf of Bangladesh and also on behalf of the Islamic Development Bank. At this point, I think that we should give thanks to M. Fahim Khan and the Islamic Development Bank who have initiated and sponsored this seminar. Fahim Khan has been working on this seminar for almost two years. Initially, the signing of the Memorandum of Understanding took almost a year and then we had some political disturbances, an election, and a cyclone. But Fahim Khan insisted that we should not delay any longer. We wanted to hold the seminar in the winter. We are very thankful to him for the energy he has extended and for his dedication in organizing this seminar.

The IDB spent almost 40 thousand dollars on this seminar. I also express our thanks to Al-Baraka Bank, who have also partly financed this seminar.

We are also very grateful to the distinguished participants from eight Muslim countries. In this concluding session we find representatives and scholars from Sudan, Bahrain, Saudi Arabia, Pakistan, Jordan, Sierra Leone, Iran, and Indonesia. We are grateful to them for taking the time to travel and making the seminar a success.

I want in particular to mention Anas Al-Zarka, Professor at King Abdul Aziz University, Jeddah, a great scholar, who is present at this seminar. Many

scholars from Bangladesh have participated in the seminar including: K.T. Hossain, the Islamic University Vice Chancellor, M.A. Hamid, Azharuddin, .Sirajul Haque, Solaiman Mondal, Shafiullah, A.H.M. Habibur Rahman, and many others.

We are grateful to the Chairman of this seminar, Janab A.N.M. Eusuf, the Secretary for the Ministry of Education. He is leaving tomorrow morning on a very important assignment abroad. But still he found the time to attend this seminar and I want to particularly mention that the Ministry of Education has had the responsibility for the implementation of this seminar. The seminar was supposed to be organized by the Islamic University of Bangladesh. But, unfortunately, they have trouble due to the shifting of the Islamic University for which reason the Islamic Foundation stepped in even though education is not our responsibility.

As a result of the recommendations of this seminar, a Department of Islamic Economics will be opened in various universities in Bangladesh. Already such a department has been opened in six universities abroad. So we want a Department of Islamic Economics to be opened at least in the Islamic University of Bangladesh as early as possible in the next academic session. This can be done by the Chairman of this seminar, Janab A.N.M. Eusuf. We are very grateful to our Minister for attending the session today.

There is a very important session in Parliament, but in spite of this our Minister found the time to come here and join us. Present among us are officers of the Islamic Foundation, Al-Baraka Bank and the Islami Bank as well as our distinguished guests. On behalf of the Islamic Foundation and the Ministry of Religious Affairs, we want to extend our sincere thanks to you. Thank you, very much.

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**RECOMMENDATIONS  
OF THE INTERNATIONAL SEMINAR ON  
"TEACHING ISLAMIC ECONOMICS AT  
UNIVERSITY LEVEL" HELD IN  
DHAKA, BANGLADESH  
(JULY 23,1991- AUGUST 4, 1991)**

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The seminar participants appreciate the effort of Islamic Research and Training Institute, Islamic Foundation, Bangladesh, Ministry of Religious Affairs, Govt. of the People's Republic of Bangladesh and the Al-Baraka Bank Bangladesh Ltd., for organizing this useful seminar and express the gratitude to these sponsors.

1. Since knowledge in *Shari'ah* and Arabic language is essential to promote research in Islamic economics, it is recommended that organizations like Islamic Research and Training Institute of the IDB and the Center for Research in Islamic Economics of King Abdul Aziz University, may come forward to sponsor diploma/certificate course in Arabic language through such bodies as the Islamic Foundation, Bangladesh, Universities of Bangladesh and also the Islamic Economics Research Bureau of Dhaka.
2. In order to create further awareness about Islamic economics and with a view to equipping the intellectuals working in the field of Islamic Economics in Bangladesh and elsewhere, it is recommended that the papers presented in this seminar be circulated among the economists of Bangladesh and other countries. It is recommended that the Islamic Foundation Bangladesh and the Islamic Research and Training Institute may take joint steps to materialize the publication of the proceedings of this seminar in a book form as early as possible. It is also recommended that important materials on Islamic economics should be made available in different languages to teaching institutions.
3. Islamic Foundation Library is recommended to serve as a depository library for all publications in Islamic economics.

4. In order to introduce "Teaching Islamic Economics at the University Level" as a preliminary step, books in Islamic economics in Bangla should be published and made available to the general readers. The Center for Research in Islamic Economics, Jeddah, should particularly be requested for this purpose.
5. Bibliography covering different languages on Islamic economics should be prepared and made available to the interested readers. Books of reading on different aspects of Islamic economics should be prepared, published and translated in various languages of the Muslim countries.
6. Elements of Islamic economics may be introduced at the Secondary School Certificate (S.S.C.) level for providing elementary knowledge on Islamic Economics in all Muslim countries.
7. Contents of Islamic Economics should be introduced in all courses of Economics at the university level in Muslim countries.
8. More postgraduation scholarships should be offered for the Muslim economists to promote teaching and research in Islamic economics.
9. Chairs may be opened at the universities in Islamic economics and fund be made available by Islamic banks.
10. Specific courses should be designed in order to enable interested students to become proficient in Islamic economics. The institutions like Islamic Research and Training Institute (IRTI), International Islamic Universities in Kuala Lumpur and Islamabad should take initiative and cooperate with each other to develop curricula and prepare teaching materials.

## **LIST OF CONTRIBUTORS**

- 1 Monzer Kahf
- 2 Muhammad Anas Zarqa
- 3 Muhammad Ata Ali Sid, Professor - Malaysian
- 4 Muhammad Siraj
- 5 Muhammad Fahim Khan
- 6 Muhamamd Umar Chapra
- 7 Munawar Iqbal
- 8 Salahuddin Ahmad
- 9 Sayyid Taher

# 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 1395H (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**

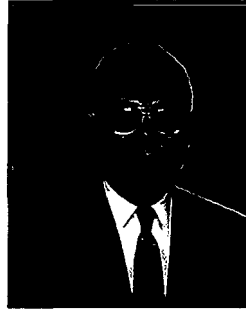
The Bank's headquarters is located in Jeddah, Saudi Arabia and it is authorized to establish agencies or-branches elsewhere.

## **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**  
***Dr. Monzer Kahf***

**Date and Place of Birth : Damascus (31/12/1940)**

**Academic Qualification :**

- B.A. in Commerce, University of Damascus, 1962.
- High Diplome in Planning, 1967.
- Ph.D., Economics, 1975 (Major: Monetary and Development and Economics)

**Publications :**

- More than Fifteen Books in Arabic and English languages.
- More than Sixty Articles in Arabic and English languages.

**Participation in Conferences and Seminars**

- Participated in many Conferences and Seminars as a Researcher and Commentator in various areas of Islamic Economics.
- Prepared and implemented several Seminars and Conferences in areas of Islamic Economics.
- Lecturer in Training Seminars in Islamic economics and banking.

**Present Occupation :**

Economic Researcher in the Islamic Research and Training Institute (IRTI) of the Islamic Development Bank (IDB).

