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Interest-Free Banking in Islamic Economics

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INTEREST-FREE BANKING IN ISLAMIC ECONOMICS

A Culminating Project Presented to the Faculty of the Graduate
School of the Lindenwood College in Partial
Fulfillment of the Requirements for the
Degree of Master (Science)

1985



ALSHARIF ABDULMOHSIN M. ALGHALIB

B.S. in Business Administration

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① أَقْرَأْ بِاسْمِ رَبِّكَ الَّذِي خَلَقَ

① خَلَقَ الْإِنْسَانَ مِنْ عَلَقٍ

① أَقْرَأْ وَرَبُّكَ الْأَكْرَمُ

① الَّذِي عَلَّمَ بِالْقَلَمِ

① عَلَّمَ الْإِنْسَانَ مَا لَمْ يَعْلَمْ

*In the name of God, Most Gracious,
Most Merciful.*

1. Proclaim ! (or Read !)¹⁰⁰
In the name¹⁰⁰
Of thy Lord and Cherisher,
Who created —
2. Created man, out of
A (mere) clot
Of congealed blood :¹⁰⁰
3. Proclaim ! And thy Lord
Is Most Bountiful,—
4. He Who taught
(The use of) the Pen,—¹⁰⁰
5. Taught man that
Which he knew not.¹⁰⁰

COMMITTEE PAGE

COMMITTEE IN CHARGE OF CANDIDACY:

Jack Kirk: Faculty Advisor, Chairperson

Clark Compton: Faculty Advisor

Miriam King-Watts: Dean, Lindenwood College

PREFACE

This project investigates the possibility of the movement and proposals for establishing interest-free banking within the systems presently existing in the Muslim countries, which range from free enterprise in the western sense to socialist attempts.

This project takes as precepts the Islamic thought in economics; it does not occupy itself with their legal and ideological justification but rather it goes on to investigate their economic significance and implications. In other words, the Islamic economy is given by assumption in this project. Its purpose is to show how this economy works and how its major variables are determined, such variables as investment, savings, consumption. It focuses on the effects of such variables as are generated by the Islamic injunctions themselves.

Before any economic analysis of the interest-free economy of Islam can be undertaken, the tremendous difference of thought among the radical and moderate thinkers is worth brief mention. The dispute is focused upon two points: whether there is any difference between consumption and production loans, and whether the rate of interest is to be considered or not. These two points are in reality merely the reflections of basic questions. Shall Muslims accept the status quo (i.e., banking with interest) which exists in Muslim countries today with some few changes, or is this status quo as a whole, un-Islamic, requiring replacement by an Islamic system?

In the Islamic literature, one can hardly find any distinction between hoarding and saving. Both are considered as the same, and the literature does not make any distinction between whether the income saved is measured in money units and is concealed under the ground or in the bank's vault as long as it is not put into the production process itself. The mere act of saving and depositing in a bank is an economically-negative action; therefore, it should be penalized rather than rewarded, and this is actually the case in Islam. The real productive act, from economic point of view, is the introduction of these savings into the production process in terms of capital, land or labor, and this act should have its reward, and so it is in Islam. This latter act is known as Mudarabah.

The abolition of interest and the establishment of Mudaraan banks will not in any way decrease the propensity to save because savings are a function of income, and earnings making interest only a minor motive for saving. In the absence of interest, the possibility of making profits on the basis of participation with mudarabah banks or by buying government-owned industrial shares will serve the same purpose. Furthermore, the major portion of savings in modern industrial countries comes from institutional sources, irrespective of interest rate and not from individuals. Above all, there will not be any very great need for liquid assets in an Islamic economy both because gambling houses, casinos and other luxurious unlawful things which create its demand will be prohibited and because of the general satisfaction

and peace of mind people will experience as a result of the Islamic reforms.

This project consists of seven chapters. Chapter one discusses Islam and economics. It deals with its methodology. Chapter two discusses Islam and other economic systems. It introduces the reader to the Islamic, capitalist, communist, and socialist economic systems. Chapter three discusses in detail the Islam economic development, and its policy implications. Chapter four introduces Riba and its transactions. It discusses Zakat as an alternative. Chapter five discusses banking in Islam. Chapter six discusses Islamic banking in Muslim countries. And Chapter seven is a summary and conclusions.

Hadith: (narrative) tale, prophetic tradition; narrative relating words and actions of the Prophet and his companions

Hajjat: (pilgrimage)

Hijrah: (migration) migration of Prophet Muhammad from Mecca to Medina and it happened in the year 622. Hijrah is the first month in Islamic calendar starting from 12th month when Muhammad accepted from Mecca to Medina. For each year there are 12 months.

Hilal: (crescent moon) crescent moon

Ibadah: (worship) devotion to God.

Istislah: (benefit) advantage, satisfaction.

Itiqad: (belief) belief, independent judgment in a legal or moral question. Individual judgment.

Jihad: (struggle) struggle.

Khalifah: (successor) successor to the Prophet Muhammad.

Ukhuwah: (brotherhood) brotherhood.

GLOSSARY

- Adl: justice.
- Al-Fuqaha: legist, jurispudent, expert in Quran.
- Al-Madinah: name of a city in Saudi Arabia where the burying place of Prophet Mohammed.
- Al Mu'amalat: social intercourse, association behavior, conduct (toward others).
- Ayah: the verses of Quran.
- Azhar: University of Islamic law in Egypt.
- Baitulmal: Treasure house, administration of vacant Muslim estates.
- Fai: shadow.
- Falah: thriving, prosperity, success.
- Fiqh: to understand, comprehend, jurisprudence in Islam knowledge.
- Hadith: (speech) tale, prophetic tradition, narrative relating deeds and utterances of the Prophet and his companions.
- Hazrat: respectful.
- H: Higrā: immigration of Prophet Mohammed from Makkah to Madinah and it happened in the year 620. *182H = 802 Date placed in Hegra calendar dating from 620 and when Mohammed escaped from Makkah to Medina. For each date add 620 years.
- Hsiba: calculation, measure extent.
- Ibadat: (worship) devotional service to God.
- Ihtisab: computation, satisfaction.
- Ijtehad: effort, independent judgment in a legal or theological question, individual judgment.
- Jehad: holy war, freedom fighter.
- Khalifa: deputy, successor to the Prophet Mohammed.
- Khilafah: succession, office or rule of a Kaliph.

Kufr: not to believe in God, to be irreligious, infidelity.

Moqaridh: interest-free loan with unstipulated due date.

Mudharibah: speculation, jobbery, prophet sharing.

Musnad: (support) ascription (of an Islamic tradition).

Quiradh: interest-free loan.

Quran: The Holy Book of Islam.

Rashidun: (good sense) the companions of the Prophet Mohammed at the beginning of his consignment.

Riba: to gain profit, to increase surplus, excess, usury.

Rubbiyyah: divinity, godship.

Sadaquah: almsgiving, voluntary contribution.

Shariah: the revealed or canonical Law of Islam.

Shukr: thankfulness, gratefulness.

Sunnah: customary procedure or action, the Sunnah of the Prophet, i.e., his sayings and doings, later established as legally binding precedents.

Ta'ala: abbreviation, most high, the supreme being.

Taqleed: (imitation) adoption of concepts or ideas.

Taqwa: godliness, God-fearing.

Tawheed: (unification) belief in the unity of God.

Tazkiyah: purity, purification, integrity or credibility.

Ulana: learned, erudite, scholar.

Ummah: (nation) the Moslim people.

Zakat: obligatory donation, alms tax in Islam.

Zulm: injustice, unfairness, to suffer injustice.

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VIII. Summary and conclusion.

The economic system of Islam offered the Muslim world a new path, which is now provided by the determination of a number of independent Muslim communities to reorganize their economies along Islamic lines, as part of a larger ambition to rebuild their societies according to the teachings of Islam. Even in those Muslim lands that do not profess an absolute majority in their countries like Egypt, Pakistan, and India, there is a serious urge to present the economic disciplines of Islam as their constitutive basis, as part of the larger efforts in persuasion of the Islamic way of life. Islam has still the most potent force in human life, capable of moving the course of history despite the great leap forward in science and technology. Muslim societies at the zenith of Islam are actually put into practice and a truly Muslim society emerges to demonstrate the superior virtues of their system to the modern man. It is mainly through the written word that we can explain and advocate it. It is, however, necessary to change the kind of certain misconceptions, before the ideas that are being presented can be properly grasped.

Protagonists of Islam's economic system are now to revive the economic structure of man based on the will of God. The modern Islamic economy will utilize the best techniques of production and methods of organization available. The Islamic

CHAPTER I

INTRODUCTION

Many past studies in the economic system of Islam suffered from a lack of immediate relevance, which is now provided by the determination of a number of independent Muslim communities to reorganize their economies along Islamic lines, as part of a larger ambition to rebuild their societies according the tenets of Islam. Even in those Muslims who find themselves in a minority in free countries like Egypt, Pakistan, and India, there is a serious urge to present the economic injunction of Islam to their non-Muslim brethren as part of the larger efforts in persuasion of the Islamic way of life. Ideas are still the most potent force in human life, capable of molding the course of history despite the great leap forward in science and technology. Until such time as the tenets of Islam are actually put into practice and a truly Muslim society emerges to demonstrate the superior virtues of that system to the modern man, it is mainly through the written word that we can explain and advocate it. It is, however, necessary to cleanse the minds of certain misconceptions, before the ideas that are being presented can be properly grasped.

Protagonists of Islam's economic system do not seek to revive the economic structure of some past period of history. The modern Islamic economy will utilize the best techniques of production and methods of organization available. Its Islamic

nature lies in the basis of human relationships, the attitudes and the social policies that constitute a system. These are not determined by the techniques and means employed. The means of production, the sources of power and the scientific techniques are capable of serving man under diverse attitudes, norms and values. The Islamic values and the attitudes they create are immensely suited for the fullest use of the techniques available to the modern man. It is in the realm of values that we look back towards standard Islamic periods of our history, especially to the age of the Prophet and the Rashidun caliphs. The Quran also confines itself to certain broad principles and values, so far as the economic aspect of man's life is concerned. The Quran does not hold any brief for a feudal, capitalistic or socialistic structure of society, or for any particular structure for that matter; it gives us clearly defined values that should guide economic policy in an Islamic society irrespective of time and place. Some examples are the owner's attitude towards his property, the society's obligations towards the needy, the cooperative basis of economic relationships, and the strong bias against concentration of wealth and towards reducing inequalities in the distribution of income and wealth.

A second point of some significance is that Islam's economic system can be properly studied only in the context of the Islamic way of life as a whole. There is no such thing as the economic system of Islam apart from the independence of the Islamic way of life as a whole. We have a corpus of injunctions relating to almost every aspect of man's life, which naturally includes what

we characterize as the economic aspect. Life itself is, however, an integrated whole in which the ultimate ends are served by a number of means, spiritual, moral, material, economic and political. Take, for example, the ultimate value-end of ibadat or tawheed: man should owe allegiance to the One God in all his thought and action. A full realization to this end is possible only when man has the correct world view, free of all spurious beliefs. Moral strength enabling steadfast adherence to the right path in face of temptations and pressures and freedom from domination by any authority, other than that deriving its sanction from God, is also necessary. The Quran also requires that man is not crushed under the strain of such privations as destroys the will, making spiritual and moral independence almost impossible. Instances can be multiplied of an economic measurement designed primarily to serve a spiritual end; a spiritual trait playing a crucial role in economic affairs and a political procedure serving an economic purpose, and so on. It is, therefore, imperative to keep in view the broad outlines of the Islamic way of life and its totality while studying some specific provisions relating to the economic system.

The above should also satisfy those who feel it necessary to assert that being an eternal message, Islam cannot possibly claim to be offering any "economic system" as such. That would be true if by "system" we were always to mean a body of specific rules relating to all aspects of the economy. But an "economic system" may also denote a set of basic principles having the potential of extended application to varying situations. It is in this sense

that laissez faire sums up nineteenth century capitalism or social ownership of the means of production epitomizes the socialist system. The teachings of Islam are far more detailed and specific than the above mentioned principles. They are capable of being applied to the modern world, along with the other teachings of Islam, to result in a living system bearing a distinct identity characterized as Islamic.

This inevitably leads us to the third important point I would like to emphasize. And that is the vast scope of variety in form. That is quite natural, as a spiritual principle is capable of taking on different forms in different periods of history in different countries. It would be preposterous for any writer suggesting the details of a modern Islamic economy to claim sanctity or finality for his views. Such details are, at best, derived or inferred from certain provisions in the Quran or the Sunnah. Of necessity, many parts of any detailed program are based on expediency, exigencies of the situation, and the insight one thinks one has acquired from the textual provision of the Shariah. They tell us how a truly Muslim scholar responds to a challenge thrown by a new situation. Though I have no hesitation in characterizing such a program as Islamic, I would like to emphasize the fact that variety of inference or ijtehad. A serious student of the Islamic economy today must be braced for controversy, even conflict of opinion, on a number of economic issues. These are the issues arising out of new situations not covered by the textual provisions of the Quran or the Sunnah. Islam cannot be indifferent to these issues in view of their

vital significance for human affairs whose conduct Islam seeks to guide and regulate. An example is provided by the prohibition of interest in an age when complexity of monetary and financial relations cannot be avoided. The principle itself is above controversy, but the challenge it throws to a student of Islamic economy is capable of evoking varied responses. Shall banking be reorganized on some other basis (as suggested by several writers who are cited later in this paper) or shall all commercial banking be scrapped and new arrangements be fostered under the aegis of the state to perform the relevant functions? Contemporary Muslim scholars are divided on this issue. Maybe a consensus is reached after some discussion; maybe different (future) Islamic states will adopt different solutions. One cannot afford to be dogmatic on such issues. The same is true of insurance, land reforms, and the relative size and role of the public sector in modern Islamic economy. These issues can hardly be avoided in any serious discussion on how to build an economic system according to Islamic injunctions. To be non-committal would be naive, but to insist that the stand taken by any particular scholar is the only Islamic stand would be going against the spirit of ijtehad.

In view of the fact that these issues are being debated for the first time (even though some of them are quite old and ought to have been disposed of much earlier), a climate favorable for creative thinking and free discussion must be created and maintained. Seen from this angle, the present state of affairs is far from being desirable. Most people seem to have developed,

undoubtedly as a result of the long-established tradition of taqleed, a strong prejudice in favor of one particular ijtehad. In fact, it is one particular scholar they select, subscribing to his opinions on all issues. They call all dissent un-Islamic, labeling it as socialism or capitalism, revivalism or modernism, orthodoxy or heresy. This can hardly be conducive to the growth of the requisite climate. It is high time we realized the true nature of opinions expressed on these issues and accepted the possibility of variety of ijtehad and, ipso facto, of variety of policy in the would be Islamic states.

Our advocacy of free discussion does not, however, mean a discussion which violates the first principles of Islamic thinking. Unadulterated and firm allegiance to the Quran as the Word of God and the final authority in all the affairs of life, a similar loyalty to the authentic Sunnah of the Prophet, and sincere desire to find an Islamic solution to all economic problems are the prerequisites to sound Islamic thinking on these issues. Such thinking cannot be free in an ultimate way ignoring guidance that is available in the Quran and Sunnah or be indifferent to finding one by inference.

Imbued with the ideas of western civilization many Muslim scholars have started finding serious weaknesses in our religious injunctions. It is a blunder on the part of any person to think that Islam is a mere religion and that its principles are out of tune with the modern world. In fact, Islam is not a religion; it is a social system, a composite code, a civilization of which religion is a part. But the fundamental principles of Islam are

challenged by different schools of thought like capitalism and communism. As followers of Islam, the Muslims have to face the situation with reasons and arguments of their faith in keeping with the intellectual standard of the modern world. Here an attempt is being made to point out the differences between Islamic and capitalistic conceptions of modern banking and to see if the former has anything better to offer than the latter.

The Quran and the Sunnah strictly forbid interest for its tyranny. Even some learned Muslims, blinded by the superficial charm of the European civilization, say that what Islam prohibits is usury and not interest. They opine that interest paid on loans for investment in productive activities would not contravene the law of the Quran for it refers only to usury on non-productive loans which prevailed in pre-Islamic times when people were not familiar with productive loans and their influence on economic development. In this the propounders of the theory of interest would appear to have overlooked that the Quran, the last of the divine messages for human guidance, legislated for all ages, and that God's knowledge as embodied in it could not be substituted by economic practice of interest of productive loans known to this or any other age. In fact, the difference between productive and so-called unproductive loans is a difference of degree, not of kind. Calling usury or Riba by the name of "interest" will not change its character since interest is nothing but an addiction to the borrowed capital, which is usury in both spirit and Islamic code of law.

As a matter of fact, there is no difference between interest and usury or Riba. Islam definitely prohibits all sorts of interest whatever high-sounding and persuasive names we may give them. But in capitalistic economy, interest is the center around which the banking system revolves. Without interest, it is argued, the banking system will become lifeless and the whole economy will be paralyzed. But Islam is a dynamic and progressive force, and it is quite possible to prove that the Islamic conception of an interest-free banking system is superior to modern banking.

By definition "the determination of human life is accordance with a law between the human soul and a spiritual law. These definitions are derived from the world and religion and to that the latter is the final standard."¹ "Islam is also defined from his book, Islamic Economics as a Challenge, by defining religion as "the set of beliefs and practices which will guide us in our present world and that will lead us toward ourselves."² Religion is mentioned by "Abdullah" as "the source of conduct."³

These definitions imply that part of the domain of religion is human behavior in all its phases and aspects. This behavior, before all else, obeys the beliefs thus indicating such behavior as ultimate objectives.

On the other hand, economics is defined as "the study of human behavior in relation to scarce resources production resources to produce goods and services and distribute them for consumption."⁴ The field of economics is the use and production

CHAPTER II

ISLAM AND ECONOMICS

Religion and Economics

To understand the relationship between religion in general and economics, one must study their respective domains and fields of operation, and examine whether they overlap and in what aspect.

In a book written by M. 'Abdullah Draz, religion is defined by Reville as "the determination of human life in accordance with a bond between the human soul and a mysterious Soul, whose domination over himself and the world man recognizes and to Whom he likes to feel attached."¹ Michel Mayer is also quoted from his book, Instructions Morales et Religieuses, lere leson, as defining religion to be "the set of beliefs and precepts which must guide us in our conduct toward God, other people and toward ourselves."² Religion is summarized by M. 'Abdullah Draz as "a chart of conduct."³

These definitions imply that part of the domain of religion is human behavior in all its states and aspects. This includes, before all else, the beliefs that determine such behavior and its ultimate objectives.

On the other hand, economics is usually defined as the study of human behavior in relation to using scarce productive resources to produce goods and services and distribute them for consumption.⁴ The field of economics is thus one sector of

human behavior which is related to production, distribution and consumption. It is apparent from comparing the definition of economics with that of religion that the former deals with a subset of the domain of the latter. One should, therefore, expect that any religion must have its say concerning the way man organizes his economic activities. Every religion has its own "Economic Ten Commandments."

In the Quran, Allah Subhanahu wa Ta'ala gives several emphatic examples of the teachings of earlier prophets in relation to economic affairs in order to stress the fact that economic behavior is one of the areas of concern of religion. Regarding the prophetic missions of Abraham and his sons, Allah says:

And We made them leaders, guiding by Our command, and We sent them inspiration to do good deeds, to establish prayers and to practice Zakah; and they constantly served Us.

The message of the Prophet Shu'aib was basically an economic message. The Quran reports him as saying:

Will you not fear Allah? I am to you an apostle worthy of all trust. So fear Allah and obey me. No reward do I ask of you for it; my reward is only from the Lord of the Worlds. Give just measure and cause no loss (to others by fraud). And weight with scales true and upright. And do not withhold things justly due to men, nor do evil in the land, working mischief.

Accordingly, from the beginning of Islam in Makkah, even before the establishment of the Islamic society of al Madinah, the verses of the Quran had presented the Islamic position on the relationship between religion and belief in Allah and the Day of Judgment on one hand and the economic behavior and the economic system on the other. Allah Subhanahu wa Ta'ala says:

Woe to those who deal in fraud -- those who, when they have to receive by measure from men, exact full measure, but when they have to give by measure or weight to men, give less than due. Do they not think that they will be called to account on a Mighty Day, a Day when (all) mankind will stand before the Lord of the Worlds?

and:

That which you lay out for increase through the property of (other) people will have no increase with Allah; but that which you lay out for charity, seeking the Countenance of Allah, (will increase); it is these who will get a recompense multiplied.

These verses, revealed in Makkah, condemn the prevailing economic behavior and provide early hints of the anticipated economic system which is consistent with this religion. It is noteworthy that these verses relate economic behavior to the doctrine of accountability before Allah on the Day of Judgment.

Although all religions deal with economic matters, they differ in their stand concerning economic activities. Certain religions look at the economic activities of many only as a necessity of life which ought to be undertaken only to the extent that provides them with mere sustenance, considering any further economic exercise beyond that limit as a misorientation of human resources or some sort of evil.⁹ Islam, on the contrary, considers the economic activities of man as an aspect of the fulfillment of his responsibility on this earth. The more man is involved in economic activities, the better he can be, provided his life is kept balanced. Piety is not a positive function of economic unproductivity. The more pious one is, the more productive he should be.¹⁰ Wealth is in itself good, and its

pursuit is a legitimate aim of human behavior, since economically productive work is a religious value in itself.¹¹

Methodology of Islamic Economics

Any economic system should be founded on an ideology which provides the economic system with its basis and objectives on one hand, and with its axioms and principles on the other. The process followed by the set of axioms and principles, in order to bring the economy closer to the objectives of the system, represents the testable ground of the system. Any economic system draws up a framework within which a socio-economic community can utilize natural and human resources for production and distribute the fruits of this production for consumption. The validity of an economic system can be tested by its internal consistency, its compatibility with the systems organizing the other aspects of life, and its provision for improvement and growth. An economic system is, therefore, not expected to provide the specific composition of the exports of a certain country, a practically useful and mathematically manageable production of function, or a proposition as to how to aggregate individual demand functions into a nationally aggregate demand. Such components of the economic theory cannot be initiated by the system since they arise in the practical application of the system under a given set of conditions. It is in the light of these conditions and within the framework of a prevailing economic system that such elements of the economic theory can be developed, tested and theorized.

Consequently, a system for the Islamic economy should be formulated on the basis of the Islamic doctrine of life. The axioms and principles of such a system should be stipulated and the process of its functioning should be clarified in order to show its purity and applicability. A lucid distinction, however, should be drawn between the economic system of Islam and any subset of it. In Islamic literature on economics, little attention has been given to this matter. As a result of this, several works claiming to discuss the "Islamic economic system," in fact, deal only with the jurisprudential background of it or sometimes with the economic principles of Islam. A study of the economic principles only falls short of a study of the economic system, just as a study of the grammar of a language falls short of creating an oratorical skill.

A distinction, moreover, must be made between that part of Islamic jurisprudence which deals with business law (Fiqh al Mu'amalat) and Islamic economics. The former draws up the legal framework for the latter, while the latter studies the process and outcome of human activity relating to production, distribution and consumption in an Islamic society. Islamic economics is constrained by the Islamic laws of business, but this is not the only constraint on the study of economics. The Islamic social system and religious precepts exert as much influence, if not even more, on the economic domain than does the legal system.

The lack of such a distinction between Fiqh al-Mu'amalat and Islamic economics has been another source of the misconceptions

in the modern literature on Islamic economics. Several works have used the tools of analysis of Fiqh in economics, while several others have studied the economics of Islam from the point of view of Fiqh. For example, the consumption theory sometimes becomes a restatement of the Islamic laws concerning foods and drinks, instead of being a study of the behavior of the consumer toward the package of available consumer goods, and the theory of production is reduced to a study of the right of ownership in Islam instead of being focused on the behavior of the firm as a productive unit.

Another great disadvantage in thinking of Islamic economics in terms of Fiqh al-Mu'amalat is that such an approach is, by its nature, fragmented, and it loses the overall thrust of the economic theory. This has, perhaps, been responsible for the noticeable absence of a macroeconomic monetary theory in all the present literature on Islamic economics.

The study of history is very important for economics because history is the laboratory of humanity. Economics, as one of the social sciences, needs to resort to history in order to carry out its experiments and to derive the long-term trends of the economic variables. History provides economics with two major indispensable aspects: the history of economic thought and the history of economic units such as individuals, firms and economics.

Little has been done to present the history of Islamic economic thought. This is unfortunate because throughout the history of Islam, Muslim thinkers and political leaders have

developed their economic ideas to the extent that allows us to look to them as the real founders of Islamic economics. Research is needed to bring to light the economic thinking of great Islamic thinkers such as Abu Yusuf (died 182 H.), Yahya bin Adam (died *303 H.), al-Ghazali (died 505 H.), Ibn Rushd (died 595 H.), al-'Izz bin Abdus-Salam (died 660 H.), al-Farabi (died 339 H.), Ibn Taymiyah (died 728 H.), al-Maqreezi (died 845 H.), Ibn Khaldoon (died 808 H.), and many others.

Such a study of the history of economic thought in Islam would help in discovering the roots of contemporary Islamic economic thought on one hand, and it would allow us to obtain a better understanding of the journey of Islamic economic thought through time on the other. Both of these enrich contemporary Islamic economics and open a broader scope for its conceptualization and application.

The study of the historical development of Islamic economics provides the empirical tests that are needed for any economic ideas. This is of great importance, especially in the area of economic policy and public finance. But a warning of two dangers must be voiced when the historical aspect of Islam is investigated. First, the danger of confusing the theory with some of its applications; and second, the danger of restricting the theory to its history. The first danger arises when modern Muslim economic thinkers do not distinguish clearly between an Islamic conception and its historical applications. This is particularly apparent in the area of public finance. Almost every work on public finance that exists in the contemporary

Islamic library considers the state resources as those which were in existence at the time of the greater Islamic state, from 'Umar b. al-Khattab to Haroon al-Rashid. Very little attention is given to developing a theory of public finance on the basis of the Quran and the Sunnah of the Prophet. This has resulted in a historical presentation of public finance in Islam which stands very little chance of testing its applicability at this time because of the change of the circumstances of all the Muslim states.

The second danger arises when Muslim economists consider the historical experience as binding on the present period. This results in an inability to approach the Quran and the Sunnah directly, which in turn, creates an Islamic economic theory that is only historical rather than ideological.

The historical approach to the study of Islamic economics is sometimes applied with respect to present-day Muslim societies. This has resulted in an Islamic economics which deals only with the problems of underdevelopment, maldistribution of wealth and income, and distorted consumption, rather than tackling the macroeconomic mechanism of the Islamic economic system. There is no doubt that the problems of the Muslim countries today are serious and important and that they must be dealt with in the framework of Islamic economics. If the Islamic economics system is a system whose subject matter is, for example, the nationalization of industry and land reform, what will happen to it after these are achieved? What will such a system do, say, for the nationalized industry or the reformed land? The

boundaries between the Islamic economic system, which is applicable to a healthy economy with a normal growth on the one hand, and the emergency measures that can be taken by the economic authorities in order to deal with a temporary problem such as a war, inherent injustice of distribution, or property on the other hand, should be demarcated. Without such demarcation, Islamic economics becomes a partial study of transitory phenomena which will be rendered redundant after the development of the Muslim countries.

This does not mean that problems such as those of development must not receive their due attention from the Islamic economists, but it means that these problems should be tackled within the framework of a general theory of the Islamic economy that preserves its relevance to all stages of economic development and political circumstances.

The diversification of modern Islamic literature on economics emerges from an inherent difficulty in this kind of study. There is no written "Economic Theory of Islam" in the strict sense of the word. Furthermore, many may even object to the term "The Economic Theory" on the ground that, if a theory is an interpretation of some aspect of reality, there could be a multiplicity of theories which inspire the Islamic philosophical values in interpreting economic reality. The confusion between these two different stands has led some writers to provide a very narrow version of the economic philosophy of Islam and to frame it in a very limited and restricted manner which does not conform to the theoretical implications of the values of this philosophy. (The

first attempt to demarcate the boundaries between the economic writers was made by al-Sadr in 1964.¹² He was followed by M. N. Siddiqi in 1971.¹³

A second type of difficulty is encountered not only by the research in the economics of Islam but by all studies dealing with the social aspects of Islam. It arises from the nature of the sources of Islam: the Quran and the Sunnah. Since the Quran is the Word of God revealed to the Prophet Mohammed to be a guide for human life and behavior, the Book is not structured into parts and chapters each dealing with one aspect of human life such as law, politics, economics, nor is it composed of headlines or titles under which one will find the applications and rules of behavior derived from them. It sometimes gives precise details--for example, in relation to the law of inheritance. In other cases, it merely outlines the solution, suggesting the way by which Muslim scholars and thinkers can set about the task of developing and filling in the non-specified details, linking them to those injunctions that constitute an obligation and interpreting them together in order to abstract a general theory on the basis of these principles and in the light of the given circumstances. To approach and develop such theories is a duty of the Muslim scholars, and the results of their efforts cannot be attributed either to Allah or to the Quran. All that can be said about it is that it is an Islamic stand, but not the Islamic stand since the effects of their circumstances on their theorization cannot be denied. Moreover, they are not granted any

authority of interpretation. In fact, no one has such a privilege.

The second source, the Sunnah, is the Prophet's understanding and application of the Quran. The difficulty presented by this source stems from the fact that the Prophet was at the same time the head of state. It is, therefore, very difficult to distinguish between his attitudes toward those injunctions of the Quran which were permanent and binding for all times, and those bound by the circumstances of his time, in addition to the difficulty referred to above. The first serious attempt to theorize the complex details from the Quran and the Sunnah in the field of economics was made in 1964, again by al-Sadr.

A last word in this section on methodology will deal with the tools of analysis. The present Islamic literature on economics has utilized two methods. The first is the method of deduction and the second is the method of retrospective thinking. The first method was developed by the Islamic jurists, al-Fuqaha', and is very common among them. It was applied to modern Islamic economics in order to deduce the principles of the Islamic system and its legal framework by consulting the sources of Islam, the Quran and the Sunnah. The second method has been utilized by many contemporary Muslim writers, who have felt the pressure of poverty and underdevelopment in the Muslim world and have tried to find solutions for the economic problems of Muslims by reverting to the Quran and the Sunnah in order to seek support for such solutions and to test them in the light of the Divine Guidance.

This study makes use of both of these methods. It should be realized, however, that these two methods apply basically to the study of the rules and principles of the Islamic economic system but have little applicability to the study of macroeconomics and the general equilibrium of such an economic system, or even to the study of the theories of consumption and production, since in these areas there is need for certain kinds of mathematical analysis. Therefore, the present study will apply the mathematical tools of analysis known in modern economic theory whenever it is felt to be necessary or useful. In fact, the Fuqaha' method is mathematical in its spirit and rigorousness.

For example, The New Testament, Matthew 19:26, in which Jesus is reported as saying:

"And again I say unto you, it is easier for a camel to go through the eye of a needle, than for a rich man to enter into the Kingdom of God. When his disciples heard it, they were exceedingly amazed, saying, 'Who can be saved?' but Jesus beheld them, and said unto them, 'With men this is impossible; but with God all things are possible.'"

Allah says in the Quran:

"Allah sets forth a parable of two men: one of them rich, with no power of any sort; he is a mountainous burden to his master; whichever way he directs him, he brings no good. Is such a man equal to one who commands justice and is on a straight way?"

Ummat al-Siba'a, Intirabiyat al-Islam, al-Madina, by al-Bayhaqi al-Andalusi, Damascus, 1960, pp. 126-127; see Ummat al-Siba'a, Ummat al-Islam, al-Andalusi, Dar al-Farabi, Beirut, 1977, pp. 12-13.

Ummat al-Siba'a, Intirabiyat al-Islam, Dar al-Farabi, Beirut, 1977.

Ummat al-Siba'a, Intirabiyat al-Islam, Dar al-Farabi, Beirut, 1977, pp. 12-13.

CHAPTER II
FOOTNOTES

¹Muhammad Abdullah Draz, Al-Din, 2d ed., Dar al-Qalam, Kuwait, 1970, p. 35.

²Ibid., p. 36.

³Ibid., p. 31.

⁴Paul A. Samuelson, Economics, 9th edition, McGraw-Hill Book Co., New York, 1973, p. 3; see also Eduian Mansfield, Microeconomics, W.W. Norton and Co., New York, 1970, p. 1.

⁵The Holy Quran, 21:73. The basic translation used is that of 'Abdullah Yusuf 'Ali.

⁶Ibid., 26:178-183.

⁷Ibid., 83:1-6.

⁸Ibid., 30:30.

⁹See, for example, The New Testament, Matthew 19:24-26, in which Jesus is reported as saying:

"And again I say unto you, it is easier for a camel to go through the eye of a needle, than for a rich man to enter into the kingdom of God. When his disciples heard it, they were exceedingly amazed, saying, 'Who can be saved?' but Jesus beheld them, and said unto them, 'With men this is impossible; but with God all things are possible.'"

¹⁰Allah says in the Quran:

"Allah sets forth a parable of two men: one of them dumb, with no power of any sort; he is a wearisome burden to his master; whichever way he directs him, he brings no good. Is such a man equal to one who commands justice and is on a straight way?"

¹¹Mustafa al-Siba'i, Ishtirakiyat al-Islam, 2d edition, Dar al-Matbu'at Al-Arabiyyah, Damascus, 1960, pp. 52-55; and Muhammad al-Mubarak, Nizam al-Islam, al-Iqtisad, Dar Al-Fikr, Beirut, 1972, pp. 19-42.

¹²Muhammad Baqer al-Sadr, Iqtisaduna, Dar al-Fikr, Beirut, 1968.

¹³Muhammad Nejatullah Siddiqi, "The Economics of Islam, Islamic Thought, Vol. 14, No. 3, Aligarh, India, 1971, pp. 22-33.

CHAPTER III

ISLAM AND OTHER ECONOMIC SYSTEMS

Islam is characterized and distinguished from the other great religions of the world in that it is not merely a religious system, but a practical and effective system of life as well, complete in every detail with the political, social and economic aspects all provided for.

"Religion" in Islam has different meaning from that in other religions. Some of the latter, as their history shows, have at times adopted a hostile policy towards science and scientific progress. Such an attitude very often ended in sad episodes, handicapping the progress and advancement of science. The religion of Islam has, unfortunately, been misunderstood as regards its attitude to science by reason of the fact that it was included amongst reactionary religions.

Chief among these errors in the understanding of Islam is the lack of proper appreciation of its relation to the state, as well as its relation to the worldly sciences. It is because of this misunderstanding that many people in the world of Islam are today advocating the separation of religion from politics, following the steps taken by nations who had in the past given obedience and allegiance to the church. Some are even advocating the adoption of the communistic economic system as an antidote to the harshness of the capitalistic system of the West. These people fear that the main purpose as far as political and economic

matters are concerned is, in essence, that there should be taqwa (fear of God). This, in actual fact, is tantamount to the presence of the ethical element in the affairs of life.

If politics in Islam is placed within the orbit of religion, what is intended thereby is that politics should be subject to an ethical rule which would free it from being abused in both the domestic and external domains. If economics is also to remain within the sphere of religion, it is because the intention thereby is to build the economy of a country and regulate its economic affairs on an ethical basis, which would prevent the occurrence of injustice and perpetuate a state of affairs where there will be equal opportunities and rewards for all, be they workers or employers.

The religious element in Islam is thus no more than the enforcement of the ethical doctrine of justice and fair play in all the various aspects of life -- nothing else. This conception has been described forcefully as "religion is treatment"; i.e., fair and good treatment free from any form of injustice. This has, in fact, been realized and enforced by the Arabs at one stage of their political history when they followed the principles of Islam, a thing which caused one famous European historian to write: "The Arabs were the first to teach the world how freedom of thought can go in harmony with religious righteousness."¹

It is not, therefore, possible to view the religion of Islam from the angle in which other religions are viewed or to divorce

Islam from the affairs of life, unless, of course, it was thereby intended to banish the ethical element from life.

It is because the problems of the capitalistic economic systems of the West flow mainly from the absence of the ethical element in economic dealings that the reader will find that the Islamic economic system, based wholly on the provision of the ethical element, is the ideal system. It occupies a unique place when compared with the extremism of the capitalistic, the socialistic and the communistic systems. The Islamic economic system attempts to combine the good attributes and merits of each of these systems without adopting their bad attributes or evils.

Islamic states would include the following: Saudi Arabia, Egypt, Sudan, Pakistan, India, Jordan, and United Arab Emirates. The prime example of a free-enterprise capitalistic system is the United States of America. Communistic systems are installed in many small European and Asian countries, but the major examples would be the U.S.S.R. and China. Socialism has been adopted by many developing nations and also in Europe with Great Britain, France and perhaps India being major examples.

Capitalistic Economic System

The capitalistic economic system is founded on the principle of the freedom of the individual to do whatever he pleases in the way of trade, industry or other economic transactions. Complete freedom is accorded to the individual to trade or produce whatever article he desires and in the quantity he desires and to deal with others with complete freedom. In other words, the capitalistic economic system rests on the policy of laissez-faire

(literally, let the individual do as he pleases) or free enterprise in both the domestic and foreign field. It is for this reason that the capitalistic economic system has been termed the "free" economic system and also the "individual economy"; because it deals entirely with the interest of the individual and makes no provision for the welfare of the community or nation of which the individual is a member.

The capitalistic economists have found that for economic life to be orderly and healthy, the following three elements must be present: personal gain, as a target; competition, as a means; and freedom, as a condition.

Communitistic Economic System

It was in the tense atmosphere of capitalism, abounding with acute problems and crowded with starving and destitute people who destroyed machinery and wrecked factories, and prompted by the sharp pens of ardent writers, that the communitistic economic system was born. Its object, from the start, was to replace the aging capitalistic economic system as a mode of life and to secure for all sections of the community an equal chance to enjoy a decent and reasonable standard of life. Its methods for achieving this were terror and violence.

The base of the capitalistic economic system is personal gain and interest. This leads to the concentration of the wealth and resources of the nation in the hands of the few, thus depriving the mass of the community from the elementary necessities of life. The interest and welfare of the majority are sacrificed for the luxurious comfort of the very small and privileged

minority. This creates a wide cleavage and gap between the different classes and strata of the community, where one class becomes hostile and opposed to the other -- in other words, the system gives rise to class warfare and exploitation.

Another basis on which the capitalistic economic system is founded is "free competition". One of the greatest disadvantages of this form of competition is that it ultimately leads to the waste of powers of production, thus preventing the best use being made of capital and resources. This proposition can be clearly perceived if we consider the fate of severe and cut-throat competitors in one range of commodity or service. They rarely, if ever, avoid economic ruin or bankruptcy.

The foregoing is an outline of the defects of the capitalistic economic system as viewed by the adherents to the communistic economic system. We will now consider the principles of the communistic economic system.

The communistic economic system is founded on the following conceptions:

(1) The complete abolition of private ownership of land and other real property and of capital and the vesting of those in the state, to be administered and exploited on behalf of the community as a whole and for the benefit of the community as a whole. This is called absolute "nationalization".

(2) The distribution of consumer goods and commodities to all the members of the community in accordance with their respective needs and requirements.

(3) Economic planning.

The propounders of the communistic economic system say that the object of abolishing the conception of private ownership of property is to remove disparity and inequality between the members of the community and to level the various classes of the community so as to end the social class system. They say that this process will result in the uprooting of the causes which give rise to severe economic grievances in the community, where the individuals in one class, by virtue of their command and hold on wealth, exploit the other less fortunate class and cause the latter to nurse a feeling of grievance and hostility against them. The capitalistic economic system has always meant, it is argued, the affluence and prosperity of a small section of the community at the expense of the by far greater majority. The abolition of private ownership, it is said, removes such economic harms and evils as result from the practice of free and unfair competition. Such a kind of competition causes a waste of the productive power and resources of a nation which can otherwise be utilized for the purpose of creating a sufficiency for the community and bringing about true equality amongst its members.

On the question of economic planning, the supporters of the communistic economic system declare that the planning and control of production to suit and serve the interest and welfare of the community as a whole is one of the sources of pride of the communistic economic system. It is the main pillar guaranteeing the security of the communistic community, and without it the communistic economic and social order does not exist. There

could be no communistic economic system if production were not governed and controlled by a well-defined program, for the absence of such planning in an otherwise communistic regime would give rise to economic crises and problems similar to those experienced under a purely capitalistic system, as already discussed.

Socialistic Economic System

It is worth pointing out, before we embark on a discussion of the socialistic economic system, that the advocates of the idealist communistic economic order, led by the leaders of the Soviet Union today, have discovered after prolonged experience that the purely communistic economic system cannot be introduced or established in a community abruptly. A nation must pass through a transitory stage that would ultimately prepare it for accepting communistic economic doctrines. In such a transitory period the introduction of communistic economic doctrines can be facilitated, and the way can gradually be paved for their whole-hearted acceptance. For this reason the communistic advocates have resorted to the introduction of a form of "economic system known as the Socialist system, which is based on ideas propounded by Karl Marx in his book, Das Kapital."² This socialistic system is an equal mixture of both the capitalistic and communistic economic doctrines.

It is not, therefore, surprising to find that the leaders of the Soviet Union today are constantly changing their plans in an endeavor to find a better and more suitable formula. This

attitude proves the existence of defects in the socialistic system as I shall endeavor to show.

Nationalization of industries does not, by itself, provide the absolute cure since, as far as the worker is concerned, to work in an industry owned by the government is neither more attractive nor more profitable than to work in a privately-owned industry -- indeed, the latter proposition is to be preferred in many respects to the former.

The Islamic Economic System

The Islamic economic system, in order to ensure freedom and fairness in competition in its battle of life by means of equal facilities and opportunities within, makes many provisions, chief amongst which are the following:

(1) The prohibition of interest on loans. The objective of this is that no individual can become rich without work or at the expense of other individuals.

(2) The prohibition of all kinds of gambling. This ensures that no one could become rich by mere accident or luck.

(3) The prohibition of the making of a will in favor of an heir. This ensures that the heir, who would in any event be entitled under the general law of inheritance to a share in the deceased's estate, should not also get an additional advantage under the will and so have a better "weapon" than others in the field of competition.

(4) A provision that testamentary wills should be in favor of those who would not otherwise have been entitled to a share in the deceased's estate under the law of inheritance.

(5) A provision that the portion of the deceased's estate which may be disposed of by will shall not be more than one-third. This ensures that the whole estate of the testator will not go to a single beneficiary, to the exclusion of the heir or dependents, thus upsetting the conditions of free competition.

(6) A large number of persons are included under the class of "heirs" and allowed a share in the deceased's estate. The purpose of this is that property should come into the hands of a wide number of persons, so that the distinctions between the competitors in life would be minimized.

(7) A provision that Zakat, should be applied to the benefit of eight classes of persons enumerated in the Quran (vide chapter, "The Immunity") and recognized as the weakest in society. The object of this is that no person shall be denied a weapon with which he can enter the battle of competition of life. The proportion of this Zakat is fixed at 2-1/2 percent of the annual value of the individual's possessions that are capable of multiplying or being enhanced, either by themselves or by the aid of an external agent.

In other words, Islam did not leave in the economic field any one class of persons like heirs or beneficiaries, to direct the economic battle on their own. All kinds of other less privileged or less fortunate persons, e.g., the poor, the weak, the orphaned, and slaves, who have been enumerated in the chapter of the Quran entitled "The Immunity", have been protected and looked after. Nor have those who are heavily in debt been forgotten. In addition to making provisions deferring the date of their

settlement of these debts until their position eases -- "If he be in dire difficulties then give consideration to easier conditions" as the Quran also states -- the door has been opened wide for these debtors to resume their economic activity afresh.

We thus find that the Islamic economic system has sought every possible means to ensure that the weapons at the disposal of competitors in the battle of life are equal in a practical and reasonable manner.

It should be noted that the Islamic economic system, by facilitating competent competition on the lines we have indicated, ensures that there will always be a large class of small capitalists every time that a very big Muslim capitalist dies. This process is also assisted by the passage of time, as with every new year the Zakat funds are distributed to the needy in such a way that when members of any one of the eight categories are nonexistent, the members of the other categories take their share.

These differences between the two systems in the conception of freedom are obvious. In the capitalistic system of the West, the conception of economic freedom has developed and undergone changes over the ages until at present a new conception of it has emerged in the form of "directed economy" -- and even this has not been finally or irrevocably settled. This conception of freedom in the Islamic economic system, on the other hand, has since its initiation, been subject to many limits and restrictions. In the wide regions of the world where the Islamic system had ruled in the past, such practices as the deliberate

destruction of products and crops by producers in order to maintain the high market price of commodities has never occurred. If such events had happened, the criminal law at the time would have been more than capable of stemming them. A study of the history of the Islamic economic system shows that it has combated monopolistic practices and imposed punishment on those who sought to monopolize markets.

It has been proven beyond any doubt that the Muslim Caliphs and the institution of Hsiba were very vigilant in supervising and controlling the market. The Caliph Umar ibn al-Khattab used to frequent the markets of Medina to inspect business activities. There were instances when he order the closure of shops because he discovered that their owners were not carrying on their business honestly and warned those shopkeepers that their shops would remain closed until they learned to conduct their business in accordance with the code of economic relations laid down by Islam. In reference books on this topic can be found chapters dealing with "Illicit Transactions", i.e., economic transactions objected to and made punishable by Islam.

Conclusion

From this short study of the nature of the Islamic economic system as compared with the capitalistic and communistic systems, the following facts emerge:

(1) That the Islamic economic system is a "capitalistic individualistic" system of a special character.

(2) That the Islamic economic system finds no place among other economic systems. This is because it is of a unique

character and is founded on principles entirely its own. It is unique because it has worked out a compromise between two apparently contradictory doctrines: the advancement and progress of the world, on the one hand, and the prevention of the emergence of a very wealthy and privileged minority wielding the immense power of capital. The Islamic economic system has achieved this result by virtue of the fact that it rests on principles entirely different from those underlying other economic systems.

(3) That the Islamic economic system has combined the best qualities of the capitalistic system without taking the bad ones. It has done likewise with the socialistic economic system. It is, however, completely alien to the communistic system, which rests on purely imaginary grounds and is impractical because it does not take into consideration the qualities and characteristics of human nature. The Islamic system is practical and factual because it recognizes human nature and its failings and makes provision for controlling them.

CHAPTER III
FOOTNOTES

¹See Ahmad, Sharkh Mahmud, Economics of Islam. Lahore: Ashraf Publications, 2d ed., 1968, p. 132.

²See Abu-Sulaiman, Abdul-Hamid, Nazariyat al-Islam al-Iqtisadiyah. Kuwait: Maktabat al-Manar, no date.

CHAPTER IV

ISLAMIC ECONOMIC DEVELOPMENT

A major challenge confronts the world of Islam: the challenge of reconstructing its economy in a way that is commensurate with its world role, ideological, political and economical. What does this demand: Economic development with a view to "catch up" with the industrialized countries of the West, capitalistic or socialistic, according to one's inclination and sympathy, or politico-economic dependence? Or does it demand total socio-economic reconstruction in the light of a basically different model, with its own set of assumptions, or ideals and growth-path, something that would be unique and value-specific? Whether the Muslim world is clear about this fundamental question or not, we will try to see in a moment. It is, however, clear from the topic we propose to discuss that our primary concern is not with the "catching up" ideology. Instead, my objective is to discern the nature and ethos of economic development in an Islamic framework.

The subject can, however, be approached in a number of ways. One may try to explore the nature and processes of economic development as they may unfold themselves in a society that is Islamic in actuality, or at least where some approximation with the norm has been achieved. This approach has a number of merits but its immediate relevance to the Muslim world situation is somewhat limited. What is more relevant and pressing is the need

to clearly identify the Islamic ideal of economic development, to measure the distance between this ideal and the present-day reality of the Muslim world and to formulate appropriate strategy/strategies for pursuing developmental efforts in such a way that an Islamic framework of life may ultimately be evolved. This formulation of the problem has immediate relevance for the Muslim economist and planner. It would be naive to think that correct answers to this problem have already been found or can be developed in one or a few papers, or even in one or a few conferences. It would be only through sustained research by a team of economists, by unceasing original thinking and, above all, by a great deal of practical experimentation that we might be able to discover an Islamic road to economic development.

We must not rule out the possibility of the appearance of a number of approaches within an Islamic framework and we should be prepared to examine them carefully and even experiment if such approaches merit such a response. It may be worthwhile to distinguish between an Islamic economy and an Islamising economy and to admit the possibility of a multiplicity of approaches/models, although with a strong central core of unity and uniformity. What follows is just one person's reflection on the problem under discussion. It is being presented as tentative formulations primarily in order to provide a basis for discussion and further exploration.

The Starting-point

Muslim countries suffer from widespread economic underdevelopment, i.e., non-utilization and/or under-utilization

of human and physical resources with consequent poverty, stagnation and backwardness. Even where those countries are resource-rich, the state of their economies remains predominantly underdeveloped. The standard of living of the common man is generally low. Some Muslim countries have over the last two decades maintained an above average rate of growth (i.e., average rate of growth of all the less developed countries), nonetheless, there has been little real economic development.¹

There are gross structural deformities within the economies of the Muslim countries. Whatever development is taking place is contributing, inter alia, to the aggravation of these deformities, viz. gross inequalities in distribution of income and wealth, severe imbalances between different geographic regions, between economic and social sectors, between sectors within the economy, particularly agriculture and industry, and a number of imbalances and iniquities within the industrial and agricultural complexes.

The paradox of the Muslim world is that it is resource-rich, but economically poor and weak. Development planning has been introduced in a number of Muslim countries. In some, the art is now at a fairly advanced level. Nigeria, Egypt, Syria, Algeria, Iran, Pakistan, Malaysia, Indonesia are some of the instances. But, in almost all these countries, developmental effort is modeled after the prototypes of growth developed by the Western theorists and practitioners of planning and "sold" to the planners in the Muslim countries via international diplomacy, economic pressure, intellectual infiltration, and a number of

other overt and covert means. Whatever the source of inspiration - the capitalistic economies of the West or the socialistic models of Russia and China - no effort worth the name seems to have been made to rethink the basic issues of development economics in the light of the ideals and values of Islam and its world strategy. A very simplified version of economic development has been adopted as policy ideal: industrialization. This is believed to depend, primarily and predominantly, on capital formation. Industry is regarded as the leading sector and expanding investment in it is believed to be the royal road to development Utopia. A rather quick way to achieve this objective is import substitution. This approach is based on extensions and variations of the Harrod-Domar model of macroeconomic planning.² Under this approach growth prospects are constrained by the operation of two "gaps" (deficiencies): the domestic "savings gap" and the "balance of payments gap"; and these gaps can be filled by one talisman - foreign aid.

It is interesting to note that even those countries which have not formally subscribed to the Western growth models and have claimed to follow some kind of a socialistic path to development have pursued a similar capital-and-aid-centered strategy. The Kalecki and Lange models both assign a central role to investment in development. Russia's international economics policy has broadly pursued this very approach.³

A comparative study of the development policy and of actual economic performance of the Muslim countries shows that the strategy of imitation has failed to deliver the goods.

How does this policy and the actual developments stand in relation to Islam? It would be correct to say that developmental policies have been more or less Islam-neutral. It is my submission that as far as Islam is concerned, it cannot be neutral vis-a-vis economic development. But there is no evidence to support that, generally speaking, the policy makers derived any inspiration worth the name from Islam and tried to translate its economic ideals into development policies, some lip-service here and there notwithstanding. Actual policies have had little or no relation to Islam with the result that the economies of the Muslim world have failed to be transformed towards Islam and the deformities and iniquities inherited from the colonial period and beyond have generally aggravated the situation.⁴

A survey of the literature dealing with Islam and development shows that even at the academic level discussion has hovered around a few points of general significance only. Western writers⁵ have mostly dwelled upon the alleged "fatalism" in Muslim society and on lack of "achievement-motivation". Muslim writers have tried to show that Islam provides for all those factors which are needed for economic development. Some work has been done to suggest the broad objectives of economic effort and enterprise that Islam wants to be pursued by the individual and society.⁶

Excepting one or two tentative yet pioneering works no serious effort has been made to spell out the implications of these goals for development strategies and policies.⁷ Moreover, the effect of the work that has been done so far is

hardly discernible at all on the actual development processes. All the evidence suggests that the actual movement towards development is altogether bereft of Islamic inspiration. If Islam comes into the picture, it is at a later stage, and mostly in either of the following two forms:

(a) Some people bring it into the debate to legitimize certain policies.

(b) Others use it as a point of reference for criticizing certain policies and actual developments.

There is, however, one point which came out prominently in this debate and discussion: Islam's main concern is in encouraging economic development with social justice and not in disregard of the demands of social justice.

Our Approach: Assumptions and Commitments

The primary task of any theory of development is to examine and explain the nature of the processes of development and factors responsible for it, to identify and analyze principle obstacles to development in a given situation, and to try to prescribe the most desirable and the most efficient ways and means to remove those obstacles and achieve various dimensions of economic development.

It can hardly be overemphasized that such an effort must be made with academic rigor and scholarly detachment. Nonetheless, it would be ideal to assume that this theorizing can take place in a climate of positivistic objectivity and of complete value-neutrality. Most of the economic thinking that masquerades as value-neutral turns out, on closer scrutiny, to be otherwise.

The result of this approach, however, is that its value-assumptions remain apparently hidden. They remain implicit, and as such, are not susceptible to evaluation in an ordinary way.⁸ This is unfair and improper.

I agree with Myrdal that "efforts to run away from the valuations are misdirected and foredoomed to be fruitless and damaging" and that:

"the only way in which we can strive for objectivity in theoretical analysis is to lift up the valuations into the full light, make them conscious and explicit, and permit them to determine this viewpoints, the approaches and the concepts used. In the practical phases of a study the stated value premises should then, together with the data established by theoretical analysis with the utilization of those same value premises - form the premises for all policy conclusions."⁹

The major contribution of Islam lies in making human life and effort purposive and value-oriented. The transformation it seeks to bring about in human attitudes and pari passu in that of the social sciences is to move them from a stance of pseudo-value-neutrality towards open and manifest value-commitment and value-fulfillment. The first premise which I want to establish is that economic development in an Islamic framework and Islamic development economics are rooted in the value-pattern embodied in the Quran and the Sunnah.¹⁰ This is our basic frame of reference.

Our second premise is that this approach clearly rule out imitativeness. The capitalistic and the socialistic models can have no place as our ideal-types, although we would like to avail from all those experiences of mankind that which can be gainfully

assimilated and integrated within the Islamic framework and can serve our own purposes without in any way impairing our values and norms. But we must reject the archetype of capitalism and socialism.¹¹ Both these models of development are incompatible with our value system; both are exploitative and unjust and fail to treat man as man, as God's vicegerent (khalifa) on earth. Both have been unable to meet in their own realms the basic economic, social, political and moral challenges of our time and the real needs of a humane society and a just economy. Both are irrelevant to our situation, not merely because of the differences in ideological and moral attitudes and in socio-political frameworks, but also for a host of more mundane and economic reasons: Differences in resource bases, changed international economic situations, benchmark differences in the levels of the respective economies, socio-economic costs of development, and above all, for the fundamental fact that the crucial developmental strategy of both the systems - industrialization through maximization of investable surplus - is unsuited to the conditions of the Muslim world and the demands of the Islamic social ideals.¹²

The body of knowledge and experience developed and structured in the form of development economics is important and useful but its real relevance and applicability to our situation is rather limited. Although literature on development economics is burgeoning, it fails to come to grips with real complex problems of the less developed countries in general, and of the Muslim world in particular. Development theory as it has developed in

the West (both in the capitalistic and socialistic countries) has been conditioned by the unique characteristics, specific problems, and explicit and implicit values and socio-political infrastructure of the Western economies. This theory cannot be indiscriminately applied to Muslim countries. Moreover, a major part of the Western development theory remains an outgrowth of the capital theory.¹³ Because of this fundamental weakness, it fails to tackle adequately the multi-dimensional problems of development.

Two major areas of development in recent development theory relate to the realization that investment in man - education, health, and other social services - is a strategic factor in the economic development of a society, and that socio-political factors play an important part in growth and non-growth alike. It is interesting to observe that the "investment in man" approach is leading to some widening of the "capital theory" as it has thrown new light on a somewhat neglected aspect of capital - the human capital.¹⁴ Consequently, a more comprehensive and integrated view of capital is being developed¹⁵, and a promising opportunity is opening to rethink the basic premises of economics and the place of man in the total framework. The socio-economic factors, despite an increasing awareness of them, still continue to be treated outside the mainstream of the theory of development and may perhaps remain so unless an interdisciplinary theory of development is evolved.¹⁶

It is instructive to observe that despite all differences in emphasis on a socio-political framework, the socialistic theory of growth also treats the problem of capital-formation and investment as the real key to growth. Both the Kalecki and Lange models assign a central role of investment.¹⁷

Development economics is presently passing through a period of crisis and re-evaluation. It is coming under attack from a number of directions. An increasing number of economists and planners are becoming skeptical about the whole approach of contemporary development economics.¹⁸ There are others who consider the application of a theory based on Western experience to a different socio-economic situation, as is being done in the less developed countries, inappropriate and injurious to the prospects of development.¹⁹ There are others who are critical of the tools and instruments of development planning and regard the alleged sophistication and mathematical refinements as pseudo-scientific inasmuch as they contain elements of simplification, abstraction and even falsification.²⁰ There are still some others who are becoming disenchanted with the very idea of growth - some because of its socio-economic and ecological costs²¹ and others because they have begun to see the limits of growth.²² In the light of this and other considerations it can realistically be suggested that the state of development economics today is not a very healthy one.²³ I, therefore, suggest that the central ideas of development economics and its suggested remedies deserve to be re-examined.

A much more critical approach deserves to be adopted towards the panaceas that have been "sold" to the Muslim countries.

The above submissions spell out some of the negative aspects of our approach, that is, what an Islamic approach to development should not be. On the positive side, we submit that our approach should be ranked ideological and value-oriented. In development economics, as in economics or in any branch of human activity, there is an area which deals with technological relationships. But such technological relationships per se are not the be-all and end-all of a social discipline. Technological relationships are important, and they should be decided according to their own rules. This means that, as against an imitative stance, our approach must be original and creative. It is only through a thorough understanding of the social ideals and values of the Quran and the Sunnah and a realistic assessment of our socio-economic situation - resources, problems and constraints - that we can adopt a creative, innovative strategy for change. As such our approach would be ideological as well as empirical and somewhat pragmatic - pragmatic not in the sense that ideals and values can be trimmed to suit the exigencies of the situation, but pragmatic in the sense that ideals and values are to be translated into reality in a practical and realistic way.

Islam stands for effort, struggle, movement and reconstruction--elements of social change. It is not merely a set of beliefs. It also provides a definite outlook on life and a program for action, in a word, a comprehensive milieu for social reconstruction. We would, therefore, conclude this

section by submitting some basic propositions about the dynamics of social change as they reveal themselves by reflection on the Quran and the Sunnah. They also provide some indicators for purposes of policy.

(a) Social change is not a result of totally predetermined historical forces. The existence of a number of constraints is a fact of life and history, but there is no historical determinism. Change has to be planned and engineered. And this change should be purposive--that is, a movement towards the right future.

(b) Man is the active agent of change. All other forces have been subordinated to him in his capacity as God's vicegerent (khalifa). Within the framework of the divine arrangements for this universe and its laws, it is man himself who is responsible for making or marring his destiny.

(c) Change consists in environmental change and change within the heart and soul of man - his attitudes, his motivation, his commitment, his resolve to mobilize all that is within him and around him for the fulfillment of his objectives.

(d) Life is a network of interrelationships. Change means some disruption in some relationships somewhere, as there is a danger of change becoming an instrument of disequilibrium within man and in society. Islamically-oriented social change would involve the least friction and disequilibria, and planned and

coordinated movement from one state of equilibrium to a higher one, or from a state of disequilibrium towards equilibrium. Innovation is to be coupled with integration. It is this unique Islamic approach which leads to revolutionary changes through an evolutionary trajectory.

These are some of the major elements of healthy social change through which Islam wants man and society to move from one height to another. The task before the Islamic leadership, intellectual as well as politico-economic, is to clearly formulate the objectives and strategy of change and the ways of achieving it and also to establish institutions and inaugurate processes through which these policies could be actually implemented.

Islamic Concept of Development

Now I would like to elaborate on some of the essential elements of the Islamic concept of development.

Economic development, according to the current literature on development, consists of a "series of economic activities causing an increase in the productivity of the economy as a whole and of the average worker, and also an increase in ratio of earners to total population."²⁴ It is looked upon as a dynamic process, involving structural changes, which produce a significant and sustained improvement in the performance of the economy, actual as well as potential, measured usually in real per capita terms and which is spread over a fairly long period of time. Its substance lies in enabling a people to meaningfully control their economic environment so as to improve the quality of life.²⁵

Islam is deeply concerned with the problem of economic development but treats this as an important part of a wider problem, that of human development. The primary function of Islam is to guide human development on correct lines and in the right direction. It deals with all aspects of economic development but always in the framework of total human development and never in a form divorced from this perspective. This is why the focus, even in the economic sector, is on human development with the result that economic development remains an integrated and indivisible element of the moral and socio-economic development of human society.

The philosophic foundations of the Islamic approach to development, discussed in detail elsewhere,²⁶ are as follows:

- (1) Tawhid (God's unity and sovereignty). This lays the rules of God-man and man-man relationships.
- (2) Rububiyah (divine arrangements for nourishment, sustenance and directing things towards their perfection). This is the fundamental law of the universe which throws light on the divine model for the useful development of resources and their mutual support and sharing. It is in the context of this divine arrangement that human efforts take place.
- (3) Khilafah (man's role as God's viceroy on earth). This defines man's status and role, specifying the responsibilities of man as such, of a Muslim, and of the

Muslim ummah as the repository of this khilafah. From this follows the unique Islamic concept of man's trusteeship, moral, political and economic, and the principles of social organization.

- (4) Tazkiyah (purification plus growth). The mission of all the prophets of God was to perform the tazkiyah of man in all relationships - with God, with man, with the natural environment, and with society and the state.

We would submit that the Islamic concept of development is to be derived from its concept of tazkiyah, as it addresses itself to the problem of human development in all its dimensions and is concerned with growth and expansion towards perfection through purification of attitudes and relationships. The result of tazkiyah is falah - prosperity in this world and the hereafter.

In the light of these foundational principles, different elements of the concept of development can be derived. We would submit the following as its essential features:

- (a) The Islamic concept of development has a comprehensive character and includes moral, spiritual and material aspects. Development becomes a goal- and value-oriented activity, devoted to the optimization of human well-being in all these dimensions. The moral and the material, the economical and the social, the spiritual and the physical are inseparable. It is not merely welfare in this world that is the objective. The welfare that Islam seeks extends to the life hereafter,



and there is no conflict between the two. This dimension is missing in the contemporary concept of development.

(b) The focus for developmental effort and the heart of the development process is man. Development, therefore, means development of man and his physical and socio-cultural environment. According to the contemporary concept, it is the physical environment - natural and institutional - that provides the real area for developmental activities. Islam insists that the area of operation relates to man, within and without.²⁷ As such human attitudes, incentives, tastes and aspirations are as much policy variables as physical resources, capital, labour, education, skill, organization, etc. Thus, on the one hand, Islam shifts the focus of effort from the physical environment to man in his social setting, and on the other hand, enlarges the scope of development policy, with the consequent enlargement of the number of target and instrument variables in any model of the economy. Another consequence of this shift in emphasis would be that maximum participation of the people at all levels of decision-making and plan-implementation would be stipulated.

(c) Economic development is a multi-dimensional activity,²⁸ more so in an Islamic framework. As efforts would have to be made simultaneously in a number

of directions, the methodology of isolating one key factor and almost exclusive concentration on that would be theoretically untenable. Islam seeks to establish a balance between the different factors and forces.

(d) Economic development involves a number of changes, quantitative as well as qualitative. Involvement with the quantitative, justified and necessary in its own right, has unfortunately led to the neglect of the qualitative aspects of development in particular and of life in general. Islam would try to rectify this imbalance.

(e) Among the dynamic principles of social life, Islam has particularly emphasized two: first, the optimal utilization of resources that God has endowed to man and his physical environment, and secondly, their equitable use and distribution and promotion of all human relationships on the basis of right and justice. Islam commends the value of shukr (thankfulness to God by availing of His blessings) and 'adl (justice) and condemns the disvalues of kufr (denial of God and His blessings) and zulm (injustice).

In the light of this analysis, the development process is mobilized and activated through shukr and 'adl and is disrupted and distorted by kufr and zulm.²⁹

This is basically different from the approach of a much wider and more dynamic concept than that of the role of production and distribution in development. The developmental effort, in an

Islamic framework, is directed towards the development of a God-conscious human being, a balanced personality committed to and capable of acting as the witness of Truth to mankind.

We may, therefore, submit that in an Islamic framework economic development is a goal-oriented and value-realizing activity, involving a confident and all-pervading participation of man and directed towards the maximization of human well-being in all aspects and building the strength of the ummah so as to discharge in the world its role as God's vicegerent on earth as the most people. Development would mean moral, spiritual and material development of the individual and society leading to maximum socio-economic welfare and the ultimate good of mankind.

Goals of Development Policy

In the light of this concept, I can formulate the general goals of development policy and more specific targets for a developmental plan for a Muslim society.

(A) Human resource development should be the first objective of our developmental policy. This would include the inculcation of correct attitudes and aspirations, development of character and personality, education and training in skills needed for different activities, promotion of knowledge and research, and evolution of mechanisms for responsible and creative participation by the common people in key developmental activities, in decision-making at all levels and finally in sharing the fruits of development. This would call for a high priority for the expansion and Islamization of education and for the general moral orientation of the people and for evolving a

new structure of relationships based on cooperation, co-sharing and co-participation. This would also entail a highly efficient machinery for the mobilization of human resources and the inculcation of a spirit of self-sacrifice and the individual's maximum contribution towards the achievement of social goals.

(B) Expansion of useful production. Continuous and sustained increase in the national product would be an important objective, but our concern would be on the one hand, the quantum and efficiency of production, and on the other, the achievement of a correct product mix. Production would not mean production of anything and everything which may have a demand or which the rich may be able to buy; production would be concerned with things which are useful for man in the light of the value-pattern of Islam and the general experience of mankind. The production of all those things whose use is forbidden in Islam would not be allowed. For those things whose use is discouraged, their production would be discouraged, and all that is essential and useful would be given priority and encouragement. In the light of this policy, the pattern of production and investment would be molded according to the priorities of Islam and the needs of the ummah. We feel that three priority areas would be:

- (i) Abundant production and supply of food and basic items of necessity (including construction material for building houses and roads and basic raw materials) at reasonably cheap prices.
- (ii) Defense requirements of the Muslim world.

(iii) Self-sufficiency in the production of basic capital goods.

(C) Improvement of the quality of life. Efforts should be made towards improving the real levels of living of all people and towards the achievement of their moral, economic and social welfare. This would call for a high priority for at least the following:

(i) Employment creation, with all its consequent structural, technological, investmental, regional and educational adjustments.

(ii) An effective and broad-based system of social security, assuring the basic necessities of life for all those who are unable to undertake gainful employment or otherwise deserve society's help and assistance. Zakat should be the nucleus of this system.

(iii) Equitable distribution of income and wealth. There would be an active income policy directed towards raising the income level of the lowest income groups reducing the ratio of inequality concentration in society and leading to a greater diffusion of wealth and power in society in general. A reduction in the extent of income differentials would also be one of the indicators of developmental performance. To serve this purpose the tax system will also have to be reorganized.

(D) Balanced development, that is balanced and harmonious development of different regions within a country and of the different sectors of society and the economy. Decentralization of the economy and proper development of all parties and sectors is not only a demand of justice but is also essential for maximum progress. This would also remedy economic dualism from which most of the Muslim countries suffer and would lead to greater integration within each country. This is an area in which principles of regional analysis and use of developments in the fields of econometric techniques and input-output analysis can be immensely useful.

(E) New technology, that is evolution of indigenous technology, suited to the conditions, needs and aspirations of the Muslim countries. The development process would become self-sustained only when we become not only independent of foreign aid, but when, after mastering the technology that has grown in a different economic and cultural environment, we are able to internalize the process of technological creativity and begin to produce technology that bears the stamp of our distinctness. This would call for a high priority for research and a new spirit to face the challenges of our times.

(F) Reduction of national dependency on the outside world and greater integration within the Muslim world. It is a direct demand of the ummah's position as khalifah that its dependence upon the non-Muslim world in all essentials must be changed to a state of economic independence, self-respect and gradual building-up of strength and power.³⁰ The defense and

independence of the Muslim world and the peace and serenity of mankind are objectives that reign prominently in our developmental planning.

If these are to be the objectives of our developmental policy then we will have to make some major changes in the content and methodology of our developmental planning. Some areas where new approaches and new techniques will have to be evolved are as follows:

- (a) We will have to abandon the use of all those simplified aggregative growth models which concentrate on the maximization of the growth-rate as the sole index of development as basis for planning. The limitations of these models and of exclusive concentration on the growth-rates are being increasingly realized by developmental economists.³¹ Our problem is extensive development of technical capacity to formulate operational plans to achieve our socio-economic objectives and to evolve new techniques through which we may arrive at more realistic decisions in the fields of investment planning, incomes and wage policy, location and regional development, reconstruction of tax structure and policy in the evaluation of developmental performance. The writer feels that in the first phase we may avoid using growth-models for purposes of actual decision-making, although we may continue to experiment with them at a more theoretical level and further intensify our search for more appropriate techniques.

In the meanwhile, on an experimental basis, techniques of system analysis and of input-output analysis (with a much widened matrix which may include a number of social inputs and outputs, as is also being suggested by some planners),³² may be tried and further developed. Similarly efforts may be made to develop a series of composite indexes to measure the effects of developmental effort on different social and economic indicators (each given a certain weight in the light of its position in our priority matrix), which should include indicators that may reveal aspects of the moral health of the nation (e.g., crime rate, divorce rate, level of corruption, litigation rate in selected areas, participation rate, industrial disputes). A number of efforts are being made in this direction,³³ and there is no reason why we cannot give these techniques a more useful and meaningful twist.

- (b) We have to adopt a multi-objective approach to development. Instead of being bogged down in econometric approaches whose usefulness is doubtful, it may be advisable to develop a more problem-oriented approach and evaluate the success of planning and development efforts on the basis of improvements in specific problem areas.
- (c) Given the conditions of international instabilities and exploitation, of internal imperfections and market deformities and the tremendous demands of developmental

efforts, it is suggested that the Muslim countries and a number of new social institutions and organizations specially established for specific objectives should play a much more positive role. At the moment governments are ill-equipped to perform this role as are private individuals. But it is easier for a government to remedy its weaknesses and establish institutions which can rectify the situation. Since one of the objectives of policy would be decentralization, we would submit that local government authorities should be developed with a more powerful base in the local population, with greater participation from the people and with a system of checks and balances and national vigilance and guidance to make them unique agencies for multi-purpose development. Even though comprehensive planning should be resorted to, it would be inadvisable to proceed in that direction without achieving efficient decentralization of power and control and without reducing the bureaucratization of society. The scholar believes that small and medium-scale private enterprise should be encouraged and developed. Local and regional authorities should not become substitutes for small and medium private enterprise; they should create the proper environment for work and development and undertake all that is needed for purposes of efficient and equitable growth of this type of enterprise. They should, however, undertake the enterprises which call for larger

investment and organization and should act as national service institutions and not degenerate into profit-making public corporations. Profit should not be the purpose of these agencies. They should be genuine instruments for value-oriented economic development and the distribution of the benefits of development to the people.

- (d) Research and Planning. Another very important area is the organization of short-period and long-period (more basic) research to think out problems and ways to seek creative solutions, reorganization and development of statistics, and planned growth of research organizations in areas where they are needed to prepare more realistic plans for the future. We need a new strategy for research to serve the ideological demands of the future.

CHAPTER IV
FOOTNOTES

¹See Pearson, Lester B., Partners in Development, London: Pall Mall, 1969, pp. 27-72, and annex 1, pp. 231-353; Amin, Galal A., The Modernization of Poverty: A Study in the Political Economy of Growth in Nine Arab Countries, 1945-1970, Leiden: E. J. Brill, 1974.

²See Hershlag, Z. Y., "Growth Models for the Middle East", in Cook, M. A. (ed.), Studies in the Economic History of the Middle East, op. cit., pp. 373-96; Myrdal, Gunnar, Assian Drama, An Inquiry into the Poverty of Nations, London: Allen Lane, 1968, vol. III, Appendix 3, pp. 1843-2003.

³Egypt (1958-70) and Syria represent this category. See Lange, Oscar, Economic Development Planning and International Co-operation, Cairo: Central Bank of Egypt, 1961; Falkowski, Mieczslaw, "Socialist Economists and the Developing Countries", Polish Perspective, Warsaw, vol. X (March 1967) reprinted in Shaffer, H. G., and Pryble, Jan, S. (eds), From Under-development to Affluence: Western, Soviet and Chinese Views, New York: Appleton-Century Crofts, 1968.

⁴See Amin, Galal, A., The Modernization of Poverty, op. cit.; Jama at-i Islami, Economy Committee Report, Karachi, 1964 (mimeo).

⁵See Waardenburg, J. D. J., "Notes on Islam and Development", (Netherlands), 1973, pp. 3-45; Alfian, "Religion and the Problem of Economic Development in Indonesia", Indonesia Magazine, no. 9 (1971), pp. 16-26; Geertz, Clifford, "Modernization in a Muslim Society: The Indonesia Case", in Bellah, Robert N., Religion and Progress in Modern Asia, New York: The Free Press, 1965, pp. 93-108; Rodinson, Maxime, Islam and Capitalism, London: Allen Lane, 1974. For a recent empirical study evaluating the relationship of religion and economic and social development see Adelman, Irma and Morris, Cynthia Taft, Economic Growth and Social Equity in Developing Countries, Stanford University Press, 1973, pp. 38-39. Cf. the views of some Muslim scholars, e.g., Rahman, Fazlur, "The Impact of Modernity on Islam", in Jurji, Edward J. (ed), Religious Pluralism and World Communications, Leiden: E. J. Brill, 1969, pp. 248-262; and Arkun, Muhammad, "Islam Facing Development", mimeographed paper circulated at JCM European Conference on East-West Relations (November 1974).

⁶See Mawdudi, Abul A'la, "Islami Nizam-i Ma'ishat ke Usul awr Maqasid" (Principles and Objectives of the Islamic Economic Order) in Mawdudi: Ma'ashiyat-i Islam, Lahore: Islamic Publications, 1969, pp. 141-164; Siddiqui, M. N. Some Aspects of the Islamic Economy, Lahore: Islamic Publications Ltd., 1970, (Ch. III: "The Quranic Norm", pp. 27-40); Chapra, M. Umar, Economic System of Islam, London: Islamic Cultural Centre, 1970. For a brief but candid review of this aspect of literature on Islamic economics see Siddiqui, M. N., "A Survey of Contemporary Literature on Islamic Economics", mimeographed paper presented to the International Conference on Islamic Economy held at Makka (February 1976), pp. 20-21 and 70-73.

⁷The Jama at-i Islami Pakistan tried to suggest an alternative strategy in its Manifesto for the 1970 Elections. It is brief but succinct and thoughtful. The Economic Programme Committee of the Jama at-i Islami Pakistan tried to prepare a more comprehensive statement of Islam's economic strategy. See Mawjudah Ma'ashi Buhran awr Islami Hikmat-i Ma'ishat (The Contemporary Economic Crisis and Islam's Economic Strategy), Lahore: Jama at-i Islami Pakistan, n.d. (1970). A recent doctoral dissertation makes a similar effort in the context of the problems of environmental engineering. See Hussaini, S. Wagar Ahmad, Principles of Environmental Engineering System Planning in Islamic Culture: Law, Politics, Economics, Education and Sociology of Science and Culture, presented to Stanford University, California, 1971. See particularly ch. VI. See also Siddiqui, Na'im, "Islam ka MIXani Nazariyah-i Ma'ishat" (Islam's Balanced Ideology of Economics) in Chiragh-i Rah: Socialism Number, Karachi, 1967, pp. 496-525.

⁸Gunnar Myrdal writes in Asian Drama, (op. cit., vol. I, pp. 31-32): "The problem of objectivity in research cannot be solved simply by attempting to eradicate valuations . . . every study of a social problem, however limited in scope, is and must be determined by valuations. A "disinterested" social science has never existed and never will exist. Research like every other rationally pursued activity, must have a direction. The viewpoint and the direction are determined by one's interest in a matter. Valuations enter into the choice of approach, the selection of problems, the definition of concepts, and the gathering of data, and are by no means confined to the practical or political inferences drawn from theoretical findings. The value premises that actually and of necessity determine approaches in the social sciences can be hidden. In fact, most writings, particularly in economics, remain in large part simply ideological . . . Throughout the history of social studies, the hiding of valuations has served to conceal the inquirer's wish to avoid facing real issues" . . . See also Myrdal, G., Value in Social Theory: A Selection of Essays on Methodology, London, (c. 1958).

⁹Myrdal, G., Asian Drama, op. cit., p. 33.

¹⁰A number of development economists have confessed that development planning cannot be ideologically neutral and that development economics is a "normative" discipline. Dudley Seers says that development is "inevitably a normative term" (Seers, D. "The Meaning of Development", International Development Review, December, 1969, p. 2). Galbraith asserts that "Economic development is an intrinsically normative subject" (Galbraith, John K., The Underdeveloped Country, Toronto: Canadian Broadcasting Corporation, 1965, p. 20); Lauchlin Currie says that in the field of development "a non-normative approach is especially sterile". (Currie, L. Obstacles to Development, East Lansing: Michigan State University Press, 1967), p. 45.

¹¹For a more detailed discussion, see Ahmad, Khurshid, Socialism ya Islam (Socialism or Islam), Karachi: Chiragh-i Rah Publications, 1969.

¹²See Ahmad, Khurshid, "The Third World's Dilemma of Development", Non-aligned Third World Annual, edited by Andrew Carvely, St. Louis, Missouri: Books International, 1970, pp. 3-18. See also Myrdal, Asian Drama, op. cit., particularly vol. I, pp. 5-35, vol. II, pp. 709-955, vol. III, pp. 1843-2003. See also Viner, Jacob, "The Economics of Development", in Agarwala and Singh, The Economics of Underdevelopment, Bombay: Oxford University Press, 1958; Kuznets, Simon, "Underdeveloped Countries and the Pre-Industrial Phase in the Advanced Countries", in Agarwala and Singh, ibid., pp. 135-153; Welch, Claude E., "The Challenge of Change: Japan and Africa", in Spiro, Herbert J., Patterns of African Development: Five Comparisons, Englewood Cliffs, N.J.: Prentice Hall Inc., 1967, pp. 63-90.

¹³"Post-Keynsian capitalist growth theory for the mature economy generically has insisted in placing capital accumulation at centre stage and focussing on the resultant secular increases in labour productivity. It has consistently emphasized the twin conditions governing such increases; the willingness of a society to refrain from consumption and the fact that the investment into which savings may be channeled will result in increased productive capacity along with increased flows of income. In the language of the Harrod-Domar tradition, it is the propensity to save and the marginal capital output ratio which determine the growth rate. One hardly needs to be reminded that the body of contemporary capitalist growth theory consists of a series of extensions and modifications of this basic Harrod-Domar relationship." Gustav Ranis, "Theories of Economic Growth in Capitalist Countries", Problems in Economic Development, ed. E. A. G. Robinson, London: Macmillan, 1965, p. 4. For a brief but precise review of contemporary growth theory see Ranis, loc. cit.; also idem, "Economic Growth: Theory", International Encyclopaedia of Social Sciences, vol. IV, London: Macmillan, 1968, pp. 408-17; Hahn and Matthew, "Theories of Economic

¹³Growth: A Survey", Surveys of Economic Theory, vol. II, London: Macmillan, 1965; Kregel, J. A., The Theory of Economic Growth, London: Macmillan, 1972.

¹⁴Schultz, Theodore W., "Investment in Human Capital", American Economic Review, vol. 51 (March 1961), pp. 1-17; idem, The Economic Value of Education, New York: Columbia University Press, 1963; Schultz, et al., "On Investment in Human Beings" Journal of Political Economy, vol. 20, no. 4, (1962); Morgan, Theodore, "Investment versus Economic Growth", Economic Development and Cultural Change, vol. 17, (April 1969), pp. 392-414.

¹⁵Johnson, Harry G., "Comments on Mr. Jon Vaizey's Paper", The Residual Factor and Economic Growth, ed., John Vaizey, Paris: OECD, 1964.

¹⁶For a critical appraisal of the economic and other social sciences from the viewpoint of their contribution to development theory see Hetzler, Stanley A., Technological Growth and Social Change, London: Routledge and Kegan Paul, 1969, ch. 5, "Other Social Science Hypotheses on Development". For a thorough critique of the development theory, see Myrdal, Asian Drama, op. cit., Appendix 3 and Currie, Lauchlin, Accelerating Development, New York: McGraw-Hill, (c. 1966), chs. 2 and 3.

¹⁷For a review of the major socialistic theories of growth, see Lange, Oscar, Economic Development Planning and International Co-operation, Cairo: Central Bank of Egypt, 1961, p. 10; Brus, W. and Laski, K., "Problems in the Theory of Growth Under Socialism", in Robinson (ed.), Problems in Economic Development and Growth, op. cit., pp. 21-54; Brenner, Y. S., Theories of Economic Development and Growth, London: George Allen and Unwin, 1966, pp. 223-47.

¹⁸See Martin, Kurt and Knapp, John, (eds.), The Teaching of Development Economics, Chicago: Aldine, 1967, Part IA and Part IIA; Myrdal, Asian Drama, op. cit.; Streeton, Paul, The Frontiers of Development Studies, London: Macmillan, 1973. Schumacher, E. F., Small is Beautiful: A Study of Economics as if People Mattered, London: Blond Briggs, 1973.

¹⁹See Baur, P. T., Dissent on Development, London: Weidenfeld and Nicolson, 1971; Seers, Dudley, "The Limitations of the Special Case", in Martin and Knapp, op. cit.

²⁰Mynt, H., "Economic Theory and Development Policy", Economics, May 1967, pp. 117-30; Vernon, Raymond, "Comprehensive Model-Building in the Planning Process: The Less Developed Economics", The Economical Journal, March 1966, pp. 57-69.

²¹See Mishan, E. J., The Costs of Economic Growth, London: Staple Press, 1967; Hodson, H. V., The Diseconomics of Growth, London: Earth Island, 1972.

²²Meadows, Dennis, et al., The Limits to Growth, New York: A Potomac Associate Book, Universe Books, 1972; Mesarovic, Mahajili and Pestel, Edward, Mankind at the Turning Point: The Second Report to the Club of Rome, New York: E. P. Dutton, rev., 1974. The debate on this issue is vast and proliferating. For a critique of this line of attack see Beckerman, Wilfred, In Defence of Economic Growth, London: Jonathan Cape, 1974.

²³For a more detailed discussion of this issue by this writer see "The Third World's Dilemma of Development", Non-aligned Third World Annual, St. Louis: Books International of DHTI International Inc., 1970, pp. 3-18. For a recent brief but succinct statement see Adelman, Irma, "On the State of Development Economics", Journal of Development Economics, 1974, pp. 3-5.

²⁴Bonne, Alfred, Studies in Economic Development, London: Routledge and Kegan Paul, 1960, p. 250.

²⁵See Burton, Henry J., Principles of Development Economics, Englewood Cliffs: Prentice-Hall Inc., 1965, pp. 2-3, Kindleburger, Charles P., Economic Development, New York: McGraw-Hill 1965, ch. I; Hagen, Everil The Economics of Development, Homewood, Illinois: Richard D. Irwin, 1968, ch. 2; Lewis, Arthur, The Theory of Economic Growth, London: George Allen and Unwin, 1955, pp. 420-35; Kuznets, Simon, Six Lectures on Economical Growth, Glencoe, Ia: The Free Press of Glencoe, 1959, ch. 1.

²⁶See this writer's Islam and the Contemporary Economic Challenge, mimeographed paper presented to the International Youth Seminar, Riyadh, December, 1973.

²⁷"God does not change the condition of a people unless they first change that which is in themselves" (The Quran, 13:11).

²⁸This is being increasingly realized by development economists. One of the lessons, insists Max F. Millikan, we must learn from the developmental experiences of mankind is to see development "as a systematic interaction of a large number of elements". See Millikan, Max F., "A Strategy of Development", in U.N., The Case for Development, New York: Praeger Special Studies, 1973, p. 25.

²⁹The Quran says: "It is God who has created the heaven and earth. He sends down rain from the skies, and with it brings out fruits to feed you. It is He who has made the ships subject to you, that you may sail through the sea by His command. He has also harnessed the rivers for you. And also the sun and the moon, both diligently pursuing their courses. He has subdued for you the day and the night and has given you of all that you ask for. If you try to count God's favours to you, you would never be able to count them all. But man is given up to injustice and ingratitude" (14:33-34). In the context of this divine policy for human sustenance and development, it is very important to say inna al-insana la-zalimun kaffar. This refers to things that disrupt and destroy the process of human development. Reference as to disvalues of ingratitude, i.e., non-utilization of what God has given, and injustice, i.e., their misuse in the social sense, see al-Sadr, M. Baqar, Iqtisaduna, (Beirut, 1968).

³⁰See the Quranic injunction: "Against them make ready your strength to the utmost of your power, including steeds of war, to strike terror into (the hearts of) the enemies of God and your enemies and others besides whom you may not know" (8:61).

³¹See U.N., The Case for Development, op. cit., particularly chs, 1 to 3. A joint study by the World Bank Research Centre and the Institute of Development Studies, Sussex, Redistribution with Growth (Hollis Chenery, Montex Ahluwalia, C. Bell, John Dulcy and Richard Jolly) London: Oxford University Press, 1974, breathes some fresh air into the debate although the canvas still remains very limited.

³²See Pajestkr, Joseph, "Social Dimensions of Development", in U.N., The Case for Development, op. cit.

³³See Adelman, Irma and Morris, C. T., Economic Growth and Social Equity in Developing Countries, op. cit.; Hakamori, H. and Yamashita, S., "Measuring Socio-Economic Development Indicators, Development Paths and International Comparisons", The Developing Economics, Japan, vol. XI, no. 2 (July 1973), pp. 111-45; Drewnowsky, J., Studies in the Measurement of Levels and Welfare, Geneva: UN Research Institute for Social Development, 1970.

CHAPTER V

RIBA

Allah said:

"God will deprive usury of all blessing, but will give increase for deeds of charity: for he loveth not creatures ungrateful and wicked. Those who believe, and do deeds of righteousness and establish regular prayers and regular charity, will have their reward with their Lord: on them shall be no fear, nor shall they grieve."

Riba is any amount that is paid in addition to the principal in any loan. Allah, Ta'ala, says in the Quran ". . . and if you repent, then you (get back) your principal with no injustice done by you nor inflicted on you." This means that all that is paid in addition to the principal is Riba, and Riba is prohibited. There is no distinction, as far as this prohibition is concerned, between consumption loans, investment loans, saving accounts, government or municipal bonds, corporate bonds, consumer loans created by the use of credit cards and mortgages. The rate of Riba is irrelevant also, that is, every interest on loans is prohibited whether the rate is low or high.

It is also clear from the verse mentioned in the previous paragraph that the lender is entitled to all the amount of the principal without any injustice inflicted to him. This implies that he is not to be charged any fees and financial expenses that result from the lending - borrowing transaction. Additionally, the lender must make no substantial losses of benefits as a result of the changes in real prices of the unit of the loan.

We should notice that the capitalistic system brought about an important external effect on the real value of the unit of borrowing, which is mostly the monetary unit, as a result of inflation that has influenced not only the developed countries but also the developing nations. Changes in the real value of the loans, by inflation, have become so substantial especially in long-term loans, that neglecting the changes would mean doing real injustice to the lender.¹

The "Ribawi" Transactions

This subsection will study the basic and most common Ribawi transactions which are encountered by Muslims living in a non-Islamic system and the Islamic viewpoint on them. It must be pointed out at the beginning that there are two categories of such transactions. First, there are transactions in which Riba is pivotal and a "sine qua non" of the transaction in a way that its elimination drops the whole transaction from practice. And second, there are transactions in which Riba is only marginal, that is, if it is eliminated the transaction remains in use and practice. This second category is like a company which produces butter but part of its liquid assets are lent out for interest; here the presence of lending for interest is not a sine qua non for the production of butter. This section will focus on the first category of Ribawi transaction. But before we proceed, it must be pointed out that all kinds of participation in the Ribawi transactions are prohibited since the Prophet (peace and prayers be on him) said: "The curse of God be on the recipient of Riba,

its payer, the writer (of its contract) and its two witnesses."²

1. Interest-bearing Loans:

Certainly the most apparent and clear Ribawi transaction is borrowing against interest; that is to borrow an amount with the condition of returning a larger amount to the lender at a later date. The interest in such transaction may take different forms such as paying a periodical constant amount while the principal is paid at the due date; paying periodical installments whose total adds up to more than the principal; or reducing the amount of the loan by the interest and receiving at the time of the contract this reduced amount while the loan (at the original greater amount) is paid at the due date. These kinds of loans are usually offered by many institutions such as banks, insurance companies, stock market brokers, credit unions, as well as by individuals.

2. Interest-bearing Credit:

Similar to borrowing against interest is the credit transaction that has interest in it such as the use of credit cards in the case when the deferred payment of the balance includes any interest, or financial charge. Also the purchase of cars that is accompanied by the so-called "finance" that included an addition of interest to the principal.

3. Saving Accounts:

These are time deposits in banks. They carry interest and they have certain restrictions on withdrawal related basically to

the time the deposit must remain with the bank.³ The interest which accrues on such accounts is Riba.

4. Mortgage Loans:

This kind of transaction is generally attached to real estate especially housing and commercial and industrial buildings. The loan is extended to the purchaser to enable him to pay the price of the estate. He pays it back with interest. A mortgage is made on the estate to protect the lender. The interest in it is Riba.

5. Negotiable Certificates of Deposits:

They "are fixed denomination marketable receipts for money deposited in a bank for a specified period of time at a contractually set rate of interest."⁴ They can be redeemed by the issuing bank only at the date of maturity, but they are negotiable so they can be endorsed and sold in the money market prior to that date.

6. Commercial Papers:

They are "short-term, unsecured, discounted promissory notes sold by a relatively small group of large businesses, directly or through dealers in order to raise cash."⁵ The face value of the commercial paper is redeemable at the maturity date. Prior to this date, it is sold at a discount. It is also negotiable. The difference between the face value and the market price of it is in the interest that is gained by the holder who waits until maturity. This difference is Ribawi.

7. Repurchase Agreements:

The borrowing dealer (or banker) contracts to sell certain negotiable assets to the lender and repurchases them later at a higher price. "The nonfinancial corporations are a main source of repurchase agreement funds. Such agreements afford corporations a relatively riskless means of minimizing their holdings of cash balances while gaining some return."⁶ This is, in fact, two transactions put in one, and if each one of them is genuine, they both are lawful. However, the fact that both of them are not genuine, i.e., the purchaser does not intend to own what he buys and the seller does not intend to get rid of what he sells; but they use the assets as a means of security which makes borrowing for interest the heart of this transaction. The interest in the purchase agreements is represented by the difference between the two predetermined prices.⁷

8. Government Securities:

They are certificates of loans issued by the government in order to borrow from the private sector. They pay a fixed rate of interest and are negotiable in the money market.⁸

9. Treasury Bills:

These represent a sort of government borrowing. They are issued for 91, 182, 270 and 365 days of maturity at fixed face value and sold at discount. The difference between the sale price and the face price is the earning of the treasury bills.⁹

10. Savings Bonds:

They are also issued by the government. They are sold at the face value and at a given rate of interest. While in circulation

they are subject to price changes depending on the difference between their par value and the market rate of interest. Similar to these are the certificates of indebtedness carrying coupons and the treasury notes. State and local government issue similar bonds and notes.¹⁰

11. Corporate Bonds:

These are loan notes issued by private businesses. They have definite maturity dates and values and a stated interest rate. They may take a mortgage form if they are secured by specific physical assets of the issuer.¹¹

In the above, only contemporary transactions that are agreed upon as Ribawi are included. Yet, there are several other transactions that may have certain relevance to Riba but since they are still disputed by some Muslim scholars, they are not included in the category of the Ribawi transactions. For example, opening a checking account with a bank that deals with Riba certainly increases the capacity of the bank to give more Ribawi loans because it adds to its liquid reserves. Also a life insurance policy that has a clause of paying to the insured certain definite amount after a determined period of time is related to Riba since this amount is calculated on Ribawi basis.

The purpose of this section was to provide some help to Muslims living in the midst of a non-Islamic system in shaping their economic behavior according to the teachings of Islam. It must be noticed that the practice of Zakah requires a collective effort for both the collection and the distribution. It also requires a certain degree of collective decision making to fill up the area of "Ijtihad". Ironically, the same thing applies to

the avoidance of Riba. Living in a non-Islamic system, one cannot avoid Riba without losing the opportunities of credit, borrowing, and growth.

Tarif Zakat

The social order of Islam provides for a number of collective measures for making individual activities serve the social good and the society look after the individual interests. Eradication of injustice, oppression and all baneful policies, enforcement of justice and promotion of humane and benevolent attitudes, are the key elements of Islamic social policy. Though this policy embraces measures spiritual, moral, and political besides the economic ones, we shall confine in this study to two economic measures only: Zakat and the prohibition of interest.

Zakat is not charity. It is a right of the "have-nots" in the wealth of the "haves".

"And in whose wealth there is a right acknowledged for the beggar and the destitute" (LXX: 24, 25).

Also, it is something entirely different from taxes levied for meeting the cost of government. It is a measure designed to transfer part of the wealth from the haves to the have-nots in society, as declared by the Prophet:

". . . (Tell them) that Allah has levied a Sadaqah in their wealth to be taken from their rich and turned over to their poor".¹²

Paying this poor-due is an act of worship which cleanses and purifies the payer.

"Take alms of their wealth wherewith thou mayest purify them and mayest make them good . . . (IX: 103).

Zakat covers almost every kind of wealth: cash and bullion, stocks and inventories, agricultural produce, cattle, mineral wealth, and other items of value. Exemption limits and rates have been fixed once for ever. As a permanent provision in Islamic law this redistributive measure is necessitated by the unequal distribution of abilities, which in turn cause unequal opportunities. This measure is supplemented by the Islamic law of inheritance in the limited sphere of the family and the kinfolk. Wealth left by those dying without any heirs goes to the public treasury.

Abolition of Interest

Whereas Zakat is a legal expression of the cooperative attitude in living, abolition of interest inhibits the self-centered egotist attitude toward life. Islam prohibits interest as it is unjust:

"And if ye repent then you have your principal (without interest). Wrong not and ye shall not be wronged"
(II: 279).

Few would deny the injustice of the interest on consumption loans. To rationalize it is to extol the right of property in the absolute sense sacrificing other human values at its altar. That is the capitalistic approach. There are, however, many people who regard interest on commercial and industrial loans as legitimate in view of the "productive employment" of the sum borrowed. But every enterprise does not result in a profit. A productive venture financed by borrowed capital may eventually meet a loss. Justice demands that the capitalistic claim a share in profits only when a profit actually occurs. It is the height

of injustice to claim a profit where none are accrued. Fixed interest payments on commercial loans invariably involve this injustice. Employment of capital in business is always liable to losses, even when the capitalist himself is the entrepreneur. Profits are always uncertain. To shun all liability to losses and demand a guaranteed return on capital advanced is doubly unjust. That is why Islam regards all interest as illegitimate, irrespective of the nature of the loan or the rate charged. Islam has provided just alternatives for profitable employment of capital. For one who does not like to employ his capital himself or in partnership with others, it is open to advance his capital to a business party who would do the business and share the profits with the capitalist. The capitalist cannot, however, escape the liability of loss. Should the business result in a loss, the working party goes unrewarded for its entrepreneurial services and the capitalist party receives only what remains out of his capital.

Wealth and entrepreneurial abilities are disparately distributed amongst men. Hence every economic system has to find some basis for a deal between the capitalists and the entrepreneurs enabling the latter to employ the capital of the former. Fixed interest payments provide such a basis in the capitalist system. This is, however, unjust to the entrepreneurs and harmful to the consumers as interest inevitably enters into prices of the final goods. Islam provides a just alternative in the principle of mudharibah briefly described above. Those who must avoid the risk of loss can give loans in which case

repayment in full is guaranteed but no interest is allowed. This method does full justice to the entrepreneur and spares the consumers from meeting the cost of such employments of capital as do not in fact prove to be productive (of which fact the losses are the witness). It is equally just to the capitalist as he gets a share in profits whenever there are any.

Abolishing interest does not necessarily imply the scrapping of the banking system as it can function on the basis of mudharibah also. There is no danger of the supply of savings falling sharply in an interest free system as earning more money is only one out of the many motives behind savings. Granting this motive, a number of investment opportunities will be available to satisfy it. The urge to earn more out of one's savings is not so weak as to die due to non-availability of riskless investment opportunities. Some people are also worried regarding public debt, as to how it could be raised without interest payments. A remarkable feature of modern economies is that the largest borrower, the state, honours its commitment to pay interest by taxing its creditors. Why should it not be possible to end this farce and get interest free loans? Investable funds for the public sector can also be raised on the basis of partnership. Mudharibah also provides a suitable basis for acquiring funds from the public.

CHAPTER V
FOOTNOTES

¹D.C. Rowan and Thomas Mayet, Intermediate Macroeconomics. (N.Y. 1972.) W.W. Norton and Company Inc. pp. 347-8.

²Reported by Muslim, *ibid.* B. V. p. 50.

³Cobin and Rosemary Campbell: An Introduction to Money and Banking. (Hindal, Ill., 1975), second edition. The Dryden Press. p. 142.

⁴Richard H. Timberlake Jr. and Edward B. Selby Jr.: Money and Banking. (Belmont, Calif., 1972). Wadsworth Publishing Camp. Inc. p. 237.

⁵*Ibid.*, p. 239.

⁶*Ibid.*, pp. 242-243.

⁷For purchase agreements that are used as a shelter for "Riba" see: Ibn ul-Qayyem, (died 751 H). Iqhathat ul-Lahfan min Massa'id ish-Shaitan. (Beirut 1975). Dar ul-Ma'rifah. Volume 2, p. 80.

⁸*Ibid.*, pp. 244-245.

⁹*Ibid.*, pp. 245-248.

¹⁰*Ibid.*, pp. 248-249.

¹¹Campbell, *Ibid.*, p. 114.

¹²Al-Bukhari: Al-Sahih, Kitab al-Zakat.

CHAPTER VI

BANKING IN ISLAM

Is it possible to abolish interest and yet have a banking system which would perform its essential functions, ensuring smooth functioning of the economy and its monetary system? This question, besides being of academic interest, deserves some attention in view of the declared intention of a number of Muslim communities to do away with interest. The model of interest-free banking presented in this paper may be examined in this context.

1. The raison d'être of this proposition is the Quran's unequivocal prohibition of Riba (interest), which Muslim jurists have always interpreted to cover all kinds of interest, usurious or otherwise, irrespective of the nature and purpose of the loan. Contemporary exponents of Islamic thought, like their predecessors, have rejected all justifications of interest. Interest is unjust as it guarantees a fixed percentage return to the lender whereas the return of business enterprise in which capital is invested remains uncertain. Money employed in enterprise is exposed to loss, which must be borne by one who appropriates the profits of the enterprise. The present arrangement, making the entrepreneur liable to all losses and absolving the capitalist of his liability, must be replaced by one in which capital's claim to profits is tied with liability to losses. Such an alternative is provided by the Islamic principle of mudharibah in which capital and entrepreneurial activity both

share the profits of enterprise and both are exposed to losses, as explained below. The present system is highly biased in favor of the capitalists at the cost of entrepreneurs. Fixed interest charges retard entrepreneurial activity and result in higher costs to consumers. The system results in an increasingly inequitable distribution of income and wealth in society as it slowly but steadily takes wealth away from other classes of society to hand it over to the moneylending classes.

A detailed discussion on the case against interest is, however, beyond our scope. We treat the prohibition of interest as a datum and proceed to present a scheme of banking free of interest. For the sake of simplicity, we assume a closed economy and leave out international financial relations from this preliminary study.

2. The proposed system replaces interest by the principle of mudharibah (profit-sharing) as the basis both of deposits and advances. A commercial bank's activities are controlled by a central bank which, despite the absence of bank rate as an instrument, controls credit and supervises the monetary system. Besides advances on the basis of profit-sharing, short term interest-free loans are also made available to businessmen, the source of these loanable funds being demand deposits of the public. Demand deposits are treated as loans repayable on demand, no profits being distributed to these depositors. Finance for the government comes from the public mainly on the basis of profit-sharing and partly as interest-free loans. The financial papers involved in this process provide the central

bank with a means of regulating the supply of cash in the system. As regards finance for the consumer, banks have only a limited role to play.

3. In its simple form, mudharibah is a contract between two parties, one supplying money capital but taking no active part in enterprise that is run by the other party which has not invested any capital. The business party agrees to surrender a specified part of the profits of the enterprise to the capitalistic party which takes the entire responsibility of any losses that might occur. In case of loss the business party goes unrewarded for its entrepreneurial services, whereas in case of profits it is rewarded by a share therein. Mismanagement of business funds or violation of the agreed lines of activity exposes the business party to the liability of the resulting losses. Either party is free to terminate the contract any time provided business can be wound up without losses and assets are converted back to cash. Contracts for a specified period of time are also valid and binding on the contracting parties.

It is possible for either party to consist of a number of persons. The business party may invest its own capital, capital borrowed from others, or capital obtained from other parties on the basis of mudharibah. In each case liability to losses attaches to the owner of the capital, excepting the loan in which case the borrower takes on this liability. Profits are distributed according to the formula agreed upon, provided that no party can be assured of a given profit irrespective of the results of the enterprise.

4. While mudharibah serves as the basis of banker-depositor and banker-businessman relationship, the bank itself is organized on the basis of partnership.¹ A number of persons provide shared capital agreeing to share all profits and losses in proportion to the capital they supply.² An elected board of directors runs the bank with the help of salaried staff, and policy decisions are, theoretically, deemed to have been taken by all the partners. As the bank's funds include loans from the public (demand deposits), the liability of its shareholders is not limited to the extent of their shares. In contrast, liability of the depositors in the "investment accounts" is limited to the extent of their deposits. As a corollary to this provision, businessmen obtaining mudharibah advances from the bank are not allowed to take long-term loans on behalf of the enterprise; they can, however, do so in their personal capacity, as stated above.

Islamic Banking in a Non-Muslim Society

Evolution in banking systems is predisposed to colossal expansion of commerce, domestic as well as international trade, technological explosion and improvement in trustworthiness of the general populace. Optimistically, institutionalization of banking has expurgated the frequencies of usury practices, excessive greed, frauds, corruption, robberies, and unscrupulous practices of loan sharks. Exclusively from a secular perspective, the existing banking system might be pragmatic, but it could be restructured to accommodate Islamic doctrine to make

it relatively more compassionate, humanistic and equally remunerative.

Functionally, banking systems in various countries may be relatively insensitive with respect to their ideologies, doctrines or dogmas. All banking systems have been designed to pragmatically stimulate saving and investment with interest as the centerpiece. Economic systems submerged in interest might have culminated in exploitation of the poor, monopolization of trade and commerce and inequitable distribution of income. Islam envisages profit and loss participation in all commercial and productive activities. Interest indoctrination is so pervasive and permeating that some countries are deliberately engaging in euphemism. For instance in Pakistan, the word "profit" is consciously used for explicit interest to legitimize government borrowing.

Credit is considered as the lifeblood of capitalism and the lender expects relevant compensation for the extension of credit. Of course, human tendency to receive guaranteed reward in the form of interest should be understandable. Philosophically, Islam presents a challenge to Muslims to accept risks and uncertainties of life and extensively participate in the economic development process through investment. In a literal context Islam, categorically prohibits payment and receipt of Riba irrespective of religious affiliations.³ However, interpretation of Riba requires clarification as Hazrat Umar wished Prophet Mohammed (p.b.h.) had lived a little longer to eliminate further possibilities of misunderstanding. To avoid

controversy, the author accepts the premise of the prohibition concept and suggests that it is worthwhile to explore subsequently the distinction between interest and profit.

A moral philosopher like Aristotle definitely condemned interest, arguing the barrenness of money and consequently its further breeding was considered illegitimate.⁴ Judaism positively forbids interest, but selective evasion is acceptable by means of the legal fiction of considering the lender to be a partner entitled to profit. Biblical utterances against interest are construed to be for consumption loans rather than for investment credit.⁵ Similarly, some Western authors have tried to locate the same loophole in Islamic doctrine that prescription against interest was temporal, but has subsequently assumed universal value.⁶ Intrinsically, Judeo-Christian and Islamic Religious Codes are being extensively violated for exclusive optimization of secular objectives.

The chief objective of this paper is to develop a module of an Islamic bank and banking practices in a non-Muslim society, fully cognizant of permeation of interest in these societies. Also it is instructive for Muslim scholars to formulate alternative strategies for avoidance of interest without involvement of pecuniary penalties. Development of an Islamic bank or suggestions for banking practices with a profit motive could be a solution, as well as could a relatively higher rate of return in the form of profit as an added incentive.

Development of Islamic Banking Concepts

Evolution of Islamic banking from the existing structures is a far-fetched dream and the radical change presents a serious dilemma. Preliminary attempts to develop interestless banking have been made by Dr. Nejatullah Siddiqui by hypothesizing absolute prohibition of Riba and assuming a Muslim society.⁷ These prerequisites are non-existent in this complex world. To establish the supremacy of the Islamic doctrine of profit, scientific methodology is to be explored. The supportive arguments have been developed to assert rationale, wherever feasible, to consummate millenium secularly, morally, spiritually and eternally.

Methodologically, it would be appropriate to develop separate strategies from creditors' and debtors' point of view. First of all, banking systems and banking practices shall be discussed from creditors' perspective and, second, the dilemma faced by the debtor shall be explored. Concepts of banking systems and banking practices are construed figuratively for optimization purposes as the literal connotation could constrain the achievement of objectives.

Profit basis of banking is in consonance with Islamic doctrine, and would be more remunerative in the long run as compared to the comparable market interest rate. Corporate profits were one and one-half times that of net interest in the U.S. economy.⁸ These profits accrued to the system despite the payment of usual interest. The corollary that the rate of return on capital exceeds that of interest is valid. However, in the

short run, it is highly probable that Riba might be more compensative. An implied virtue of the profit basis is that relatively more undistributed corporate profit could be ploughed back and would consequently achieve capital formation for the society.

Before embarking upon development of a model of Islamic banking, it is absolutely essential to clarify certain concepts which have been part of the general lexicon, as it is felt that conceptual ambivalence has not diminished; rather it might have multiplied. Specifically, Islamic concepts need to be discerned from economic jargon to try to achieve some policy recommendation.

Profit: In economic terminology, profit is residue after land, labor and capital are appropriately compensated. Profit could be attributed to the assumption of risk, innovation, superior entrepreneurship and existence of monopolistic element whether manipulative or natural. Manipulative monopoly is exploitative and is consequently declared illegitimate.

Islam, like classical economics, conceives profit as a reward for the use of capital and is left over after payment of employee compensations and rent assignment for land use.⁹ Risk is a bellwether for profit,¹⁰ but other elements contributing to profits have not been appropriately discerned in Islam. Nevertheless, innovations, and entrepreneurial talent are for profit computation. In view of this, entire profit cannot be exclusively allocated to capital and necessitates reconciliation of this conceptual misunderstanding.

Riba: (interest)--In economic jargon, interest is the price paid for renting money. The rate of interest in the United States depends upon discount rate, degree of risk, service charges, expected rate of return on capital, loan duration, collateral and credibility of the borrower.¹¹ The main determinant of interest in most countries is the discount rate charged by the central bank.

The argument about risklessness put forward by Muslim intellectuals for the prohibition of interest may not hold, as risk is partially embedded in interest. Injunction against hoarding, exploitation and encouragement of partnership in community and economic development through investment could be a logical derivation for the prohibition.

Capital: Capital is a man-made aid to enhance production and it includes tools of all kinds, machines and factories. The Islamic perception is the general concept plus money and food stuff¹² and this ambiguity creates an interpretational dilemma. It is just a matter of personal opinion and reconciliation as to whether or not these concepts would violate the intentional aspect of religious code. To run enterprises more effectively, accumulation and optimum utilization of capital commensurate with land and labor would improve the standard of living of humanity.

Conceptually, capital has to be distinguished from money. Money is anything acceptable in a given society for the purchase of goods, payment of debt and measurement of wealth. In the U.S. money stock, five concepts are detailed ranging from M1 to M5.

Money invested in capital goods should be construed as capital. The common error among laymen is to use capital and money interchangeably, but it might be tantamount to economic heresy. Investment in capital goods is encouraged for economic development and is rewarded with profit, which is attributable to its relevant contribution. In addition, profit could accrue to other commercial activities where money as such would serve as a lubricant for an economic system. Accrual of profit from commercial activities is also theologically justifiable.

Consumption

The act of consumption embodies utilization of goods and services for human satisfaction. All theologies are unanimous in their conclusion that subsistence level of living is an inalienable right of human beings and governments have moral obligations to fulfill this objective. In an Islamic state, a part of Baitulmal should be expended for the provision of the basic necessities of life. In the U.S. welfare programs have been designed to achieve the same objective. Beyond subsistence, there are comforts and luxuries which could be categorized as semi-consumption from the Islamic perspective, as the cardinal virtue of Islam is: "Those when they spend, are not extravagant and not niggardly, but had a just balance between these extremes."¹³ Skepticism exists for interestless financing of semi-consumption activities, and a deterrent against excessive consumption has to be built into the proposed Islamic banking. Of course, a given society has to develop its own criteria for

classification of consumption in view of its relativistic attributes.

Permissible Charges

Service Charges: An administrative cost of credit extension is admissible, and the prophet is said to have distinguished between Riba and service charges. Service charges are construed just like fees or commissions for rendering a service and their permissibility is incontrovertible. The proposed Islamic Development Bank in Saudi Arabia is contemplating to prescribe service charges for advancement of loans. Not even one author rationalizes imposition of a service charge to serve as deterrent against excessive as well as unreasonable loan demands.¹⁴ Realistically, this contention is contestable in view of the minuscule magnitude of service charges.

Indexing: Repayments of the real principal amount is obligatory on borrower and there may be no scope for skepticism. Inflationary expectations are becoming a universal phenomena. In the last decade, inflation has assumed staggering proportion as the Consumer Price Index rose 74 percent in the U.S. from 1967 to 1976.¹⁵ Especially, in 1974 and 1975, the rate of inflation escalated to fourteen percent. Generally, inflation is a regressive tax and creates inequities in the distribution of income, and similarly, deflation could be inimical to the business interest. Indexing of principal amount within constraints, commensurate with inflation or deflation, appears to be a logical proposition. In some years, indexing might be restrained by usury laws as, for example, the Texas Constitution

does not permit interest exceeding ten percent. Also maximum interest payable on time and saving deposit would penalize depositors. In many developing nations, where the rate of inflation has been in excess of 20 percent, financiers received devalued principal. In an incomplete market (barter) economy, absence of inflation is understandable, and reference to such an episode has been scarcely cited in the Islamic Literature.

Development of Islamic Banking

After elucidating some important concepts entwined in the banking system and Islamic theology, it may be appropriate to summarize the development of Islamic banking. Transformation of existing banking into Islamic banking instead of revolutionizing the central materialistic objectives would be subservient to humanistic goals. However, pragmatism justifies the development of alternatives which are equally competitive, profitable, and simultaneously strengthen their faith in Islamic ideology.

As pointed out earlier, banking is interpreted in a figurative context. An Islamic commercial bank along with specialized financing agencies, like investment clubs, saving and loan associations, and cooperatives would complement each other for optimum financial requirements. Restructuring of these financial institutions to serve the Muslim community is the real objective of this paper. Only the policy aspects of the banking shall be elaborated and the procedural matters can be sorted out when implementing the proposal.

Commercial Bank

A Muslim commercial bank can be initiated with usual issuance of capital and a state charter instead of federal charter for lenient treatment of the profit basis of banking. There is a precedent in the Amish community in the United States for exemption from social security taxations and in view of Islamic injunction against Riba, one of the states could be persuaded to grant an exempted charter.

For successful operation of an Islamic Bank the following assumptions are in order:

1. Muslims accept the doctrine of custodianship of property and wealth, for everything belongs to God Almighty.
2. Enough Muslims are prepared to venture into the profit basis of banking.
3. The Islamic bank is willing to specialize in certain activities with optimum diversification within constraints.
4. Management of the bank is fully dedicated to Islamic principles and aggressive enough to take the initiative to fulfill planned Islamic objectives.
5. Investors and depositors are guaranteed at least the same rate of return in the long run as one could secure from the prevailing market interest rate.
6. Borrowers are flexible enough in their temperament for new modus operandi for operational purposes.

Demand Deposit: The most important function of a commercial bank is the provision of checking facilities for the Muslim community to consummate normal transactions. This operation will

be competitive with existing commercial banks, however, loans generated through fractional reserve requirements against checking accounts should be strictly utilized for consumption purposes and overflow could be allocated to semi-consumption or short-term commercial activities. A service charge may be used against consumption loans, whereas service plus indexing of principal has to be adopted for semi-consumption and short term commercial loans. Of course, the management has to be realistic that the creation of money with fractional reserve requirements against checking accounts can accomplish the humanistic objective of service to the community.

Deposit Account or Saving Account: In this instance, depositors are committing their money for relatively longer periods of time. Just like other commercial banks, the bank has exclusive rights to manage the investment. The Islamic bank should hire specialists for investment in stocks, real estate, its own office building complex, commodities, factories and industries in conformance with Islamic ideology. Investments have to be extensively diversified to minimize the risk.¹⁶

The bank should encourage Muslim enterprises. As at this state Muslims have not ventured and participated significantly in the free enterprise system of the United States.

Investment Portfolio: Investment portfolios are controlled by the individual investor, and the bank is only performing advisory service. The bank has the right to charge commission for rendering the service. The bank can guide the individual as

to the growth possibilities of various businesses and point out injunctions against investment in certain companies.

Savings and Loan Associations

A Muslim saving and loan association can be organized to perform the specialized service of long-term investments, specifically providing loans for automobiles and home purchases. From Islamic point of view, these institutions are to be restructured to cope with semi-consumption category of loans. Leasing of cars and homes is permissible and is perfectly in conformity with Islamic perspective. The saving and loan association shall buy homes and automobiles for its customers and in turn lease it to them at competitive rates. Provision has to be made, that eventually the lessee shall be able to purchase whenever it is possible. Incentives, in the shape of cumulative equity for the lessee and optimum profits for financier, are supposed to be built into the system for a competitive strategy. At this stage a young couple cannot purchase a home or a car, but with this proposal, depositor as well as lessee shall be able to fulfill his objectives without violating the Islamic doctrine. Nowadays, Muslims are extensively violating the Islamic code due to lack of alternatives. Of course, the lessees would be penalized for their inability to take tax breaks. For high income brackets, it might pose a serious dilemma.

An alternative to the leasing proposition is to charge a service charge plus indexing of principal and evaluate if it could be mutually beneficial to depositors as well as borrowers.

Investment Clubs

Muslims who have surplus funds and are willing to undertake risk, should organize themselves into investment clubs and invest in Islamically justifiable corporations. Accordingly, Muslims may invest in common stocks and preferred stocks, but refrain from mutual funds, debentures, promissory notes and bonds. Optimistically with collective advice, expertise, and huge funds, investors should be able to earn a higher rate of return than the prevalent interest rate. From hindsight, it is apparent that an appreciation in the Dow Jones Industrial Average along with dividends has outperformed interest rates over a long period of time. Eventually, these investment clubs might blossom into savings and loan associations or even commercial banks. This strategy would also provide a tax-exempt dividend per family. Investment clubs shall not be permitted to use margin requirements for additional stock purchases, as it would involve interest payments to the brokerage house.

Cooperatives

Cooperatives rather than competition is emphasized in the pursuit of good causes and there can be no better cause than service to Islamic Ummah.¹⁷ Virtues of cooperatives are voluntarism and democracy. In the specialized field of consumption and credit, cooperatives have a record of profound success. Most of the Statistical Metropolitan Areas in the United States have a significant number of Muslim residents to organize effectively into cooperatives. At this stage, these cooperatives should be multi-purpose to serve membership in terms

of groceries, consumer credit, housing, automobiles and investments. The rich members of the Muslim community should sacrifice for their not-so-fortunate brethren. Cooperatives are conducive to the development of brotherhood as all members are treated equal regardless of their stations in life.

Conclusions

Development of Islamic banking in a non-Muslim society is quite complex in view of the fact that innumerable diametrically opposed forces are competing against sacrosanct Islamic ideology. Undoubtedly some of the theological issues necessitate clarification, as the Ayah in which Riba is categorically prohibited was revealed almost at the end. However, scientific methodology has been utilized to rationalize the concepts of profit, capital, consumption and indexing. Disorientation from interest presents a formidable challenge and superior rationale along with competitive strategies could dislodge entrenched indoctrination. An outline of Islamic banking system to consummate needs of the Muslims has been suggested. The proposed banking system is based on profit rather than interest. Through the development of restructured commercial banks, saving and loan associations, investment clubs and cooperatives, Muslims could be better off morally, spiritually, secularly, and Insh-Allah eternally.

CHAPTER VI
FOOTNOTES

¹The government or an individual may also establish a bank supplying the entire capital. I do not discuss these exceptional cases for obvious reasons.

²While proportionate sharing of losses is obligatory, the shareholders are free to share profits disproportionately. I do not discuss the need and desirability of doing so for the sake of simplicity.

³Al-Quran. 2: 275-279

⁴Sheikh Ahmed et al, Islamic Ideology, Karachi, (no date). p. 23.

⁵Paul A. Samuelson, Economics, 9th Edition, New York, 1975, p. 603.

⁶Maxine Rodison, Islam and Capitalism, New York, 1973.

⁷Nejatullah D. Siddiqui, Banking Without Interest, Lahore, 1974, pp. 1-182.

⁸Federal Reserve Board, Federal Reserve Bulletin, Dec. 1976, 20, A53, and A54.

⁹Mufti Muhammad Shafi, Distribution of Wealth in Islam, Karachi, 1968, p. 14.

¹⁰Federal Reserve Board, Federal Reserve Bulletin, Dec. 1976, 20, A53, and A54, p. 41.

¹¹Charles L. Prather, Money and Banking, Homewood, Ill., 1975, p. 13.

¹²Mufti Muhammad Shafi, Distribution of Wealth in Islam, Karachi, 1968, p. 14.

¹³Al-Quran. p. 25: 67.

¹⁴Muslehuddin Muhammad, Economics and Islam, Lahore, 1975, p. 71.

¹⁵Federal Reserve Board, Federal Reserve Bulletin, Dec. 1976, 20, A53.

¹⁶Nejatullah D. Siddiqui, Banking Without Interest, Lahore, 1974, p. 44.

¹⁷Sheikh Ahmed et al, Islamic Ideology, Karachi, (no date). p. 77.

CHAPTER VII

ISLAMIC BANKING IN MUSLIM COUNTRIES

A. Terminology

In this section, the following forms will be used in their corresponding implications:

1. Islamic Banking: Financial institutions undertaking most or all banking services without charging interest, or Riba, which is hereby considered prohibited.

2. Banks (except Islamic): All around the world are financial institutions which are not allowed to engage in any entrepreneurial activities. Their main function is confined to accepting deposits bearing interest or not bearing, to lend money bearing interest, to render some financial services against commission and in some cases, to borrow from other banks against interest. Such banks are required by their respective laws not to invest any of the money, capital or deposits entrusted to them in any business enterprise except in the most restricted cases prescribed by the law.

3. Muslim: By "Muslim society" we mean a society whose majority of individuals embrace Islam as a faith, but which is not necessarily adopting the Islamic laws in its legal system and everyday life.

4. Islamic: On the other hand, by "Islamic society" we mean that society which is applying the Islamic jurisprudence and laws in all its activities.

Thus, "Islamic society" is rather the ultimate society which Muslims endeavor to achieve. The following political states would be considered as "Islamic societies": Saudi Arabia, Egypt, Sudan, Pakistan, India, Jordan and United Arab Emirates.

B. Methodology

It is common knowledge that the economic system of a society has its roots in and develops its basic conduct from the principles of the ideology which prevail in that society. The economics of capitalistic systems derives from Western liberalism, whereas communistic and socialistic economics are inspired by Marxism. Each of these systems represents a phase of human activity in society and is designed to serve and help the realization of its ideology. Hence, any particular sub-economic structure in a society is supposed to follow the general pattern dictated by the doctrine stemming from the society's ideology. It is rather unthinkable, if ever practical, to establish a capitalistic economy in a communistic country and vice versa.

Muslim countries are mostly following the Western capitalistic economic doctrine. A few of them have tried the Western socialistic or communistic ideology, but the experience proved to be a failure and all such countries are now going back, at different tempos, to Western liberalism. They are dismantling their socialism step by step and are paying a high price for the failure of their experience.

Socio-Political Grounds

It may serve a good purpose to investigate the reasons of this failure and to try to find why these countries had, in the

first instance, adopted the Western idealism, why they then chose socialism and finally why they are returning again to liberalism.

Muslim countries lived for centuries under the Islamic Shariah and produced one of the most elaborate civilizations in the history of mankind. But as they became lax in observing the Islamic laws, their decadence began, and they succumbed to European invasions and colonization. With the conquest by the West, the new materialistic doctrines prevailed and all Muslim countries, partly or wholly, gradually or abruptly, abandoned their Islamic laws and regulations and replaced them with the conqueror's system.

After the Second World War, most of these Muslim countries regained, though not fully, their political independence. They have found that the system introduced by the colonizers was designed to serve the colonizers and not the natives. The people wanted to go back to their Islam, while the governments, under different pretexts and pressures, insisted on ruling by the "imported" system. The people were not content and progress in all walks of life was slow and far behind their least of aspirations.

It is a lamentable fact that, although an overwhelming majority of masses in all Muslim countries yearn for an Islamic state which adopts Islam as the ideology and a socio-economic system as derived therefrom, not one single country in the world can claim it has responded to the people's desire and will and has fully adopted the Islamic ideology together with its doctrines and system.

The importance of the above short analysis is to illustrate the impracticality of establishing any Islamic system or even a model amidst an alien ideology and by the side of rather contrary doctrines. Such a trial is not only hazardous, but it cannot survive for long unless it is backed by an extraordinary popular support which defies many of the outstanding non-Islamic institutions and systems. Banking is no exception to the rule.

C. Islamic Banking

From the definitions mentioned at the outset, Islamic banking means to me the financial institutions which undertake the usual banking activities without taking or giving interest. Some Muslim economic thinkers, in an effort to bring such Islamic banking into reality, suggest that all banking services, whether commercial, industrial, agricultural or real estate banking, should be nationalized and thus become a public service. Their main plea is that money has universally become state monopoly and money is the unique "commodity" in which conventional non-Islamic banks deal. To them, it is more expedient to nationalize all banking institutions and transfer the banking activity from the private sector to the public one. The exponents of this proposition frequently refer to banking in socialistic countries and to the nationalization of different key industries and services in some important capitalistic countries, such as England and, to a lesser extent, France.

The parable between banking in a socialistic country and the would-be nationalized banking in a Muslim country and adopting a

Western economic liberal doctrine is not valid nor assuring. The discrepancy arises from two elements:

1. Nationalization as a principle is alien to the Islamic doctrine. It is, in fact, an adjunct of socialism where private ownership is not allowed except to a negligible extent and where compulsory state direction is the prevailing feature of government. I think that nationalization as a principle is at great variance with the basic Islamic economic principles. If it was to be allowed, this should be as the exception that confirms the rule of liberty of action and should be confirmed to the strict necessity that would justify its specific application.

2. In the most socialistic-oriented liberal economies, such as that of England, not even the extreme leftists ever suggested the nationalization of banks. The reasons behind such exclusion are numerous; some are obviously ideological and some are technical. It may suffice to mention here that to nationalize banking activities means to subject almost all transactional money to government control. Besides, there is always the possibility of the treasury creating more money, i.e., create credit. To nationalize banks would give a government a tremendous potential borrowing propensity, enabling the authorities to determine almost the totality of the three curves of investment, savings, and consumption. Whether such a situation is commendable or not, is of course open to question.

To conclude this theoretical aspect of the subject, I should like to stress a fact to which I referred at the outset of this paper: Banking is only one of the instruments in use by a

society and is bound to be molded to fit the economic doctrine adopted in that society.

Islamic Banks in Practice

Having excluded interest from Islamic banking, the idea of merely lending money for a period of time without any increment over the principal becomes difficult to accommodate. The only Islamic way for a bank to function is to participate with those who need the money in their enterprises, taking the risk, i.e., accepting the principle of equal chance for profit and loss. Such functioning, however, would immediately change the classification of the institution from "a bank" to a corporation or a business firm, which is practically the case. In simple words, a financial-cum-business institution can be established to undertake all the activities and services of usual banks, except for lending or borrowing with interest. We shall discuss here the cases of interest-free lending and borrowing as actions, internally and externally, even when such transactions are conducted with foreign banks.

The Islamic Bank of Dubai'

This is a living example of an Islamic institution which undertakes all banking operations without interest. It is a limited stock (or incorporated) company established in that small state beside 28 foreign commercial banks representing most of the Western countries. From the objectives of the bank as specified in its by-laws, one can see that its activities are not confined to the traditional commercial banking, but encompass all

industrial and real estate transactions as well as commercial trading and agriculture. The objectives are:

1. Undertaking all banking operations and services for its account or the account of others.

2. Undertaking investment operations either directly or by means of buying existing projects or financing projects or activities belonging to others. The company (i.e., the bank) may participate in any way whatsoever with other institutions which undertake activities similar to its own, or which may help it realize its objectives, either in Dubai or abroad. It may buy such institutions, or annex them to it through any legal act such as amalgamation or affiliation.

3. Accepting money deposits of all kind, either for safety or for investment.

4. Buying and selling of gold imports and foreign currencies as well as buying and selling its bills.

5. Financing for short terms against the collateral of commercial papers.

6. Opening of credit and extending all banking facilities against or without personal guarantee.

7. Issuing letters of guarantee for a third person against or without guarantee.

8. Collecting the proceeds of promissory notes and bills of exchange; and the delivery of bills of lading and other related documents on behalf of its clients or a third person by charging fees.

9. Floating shares and accepting subscriptions in other stock-limited companies and also, buying and selling shares for its own account or the account of others.

10. Undertaking the activities of saving banks and saving institutions.

11. Safe-guarding all kinds of monies, precious metals, documents, parcels and packages, as well as rendering private safes.

12. Undertaking the activities of guardians and representatives as well as accepting representatives and appointing representatives.

13. Utilizing modern banking machinery that enables the company to function promptly, save time and realize accuracy, including electronic machinery for the company's account. It may rent the services of such machinery to others.

14. And, in general, the company shall have the right to undertake all other banking activities and services and all other services permissible under valid banking laws and regulations.

The company shall also have the right to undertake "interalia" and as examples but not exclusively the following activities in realizing its objectives, either by means of initiating institutions or financing outstanding ones:

i. All enquiry and investment operations related to investing capital, extending to others all services concerning such operations, including advice and consultation.

ii. All construction, contracting and the related engineering industries as well as the electric and mechanical operations and related activities.

iii. The establishment of commercial companies and purchasing and selling shares of such companies.

iv. The establishment of purchase of factories and marketing of their products.

v. The establishment of banks and investment companies of every kind, and undertaking all related activities or other similar to them.

vi. All activities concerning mines, extraction of oils, quarries and other material from natural resources.

vii. All agricultural investment activities.

viii. The purchase of land and real estate for the purpose of selling or renting them in the same conditions or after partitioning.

ix. All operations of import and export of all kinds of goods.

x. The purchase of goods and merchandise for the purpose of selling or sub-letting the same.

xi. All activities related to sea and air navigation, land transport, road construction and leveling, construction of bridges, dams, dry docks and their maintenance, tanks and depots and warehouses, either on harbour docks or within land.

xii. The storage of goods and agricultural products and all mobile foods.

xiii. The establishment of cooperative institutions in accordance with Islamic laws in view of insuring its own assets, money deposits and all other liquid and fixed values, as well as the establishment of cooperative insurance for the benefit of others.

xiv. The ownership of all kinds of certificates of inventions, commercial trademarks, certificates, privilege and publication rights which the company deems necessary for its own activities. The company may utilize the same, trade in them and dispose of them in any legal way.

These are vast and quite comprehensive objectives for any bank of any qualification. They reveal the nature of the Islamic banks' functioning which takes the following aspects:

(1.) Deposits: These are accepted either as

- a. current account
- b. saving
- c. investment account

Deposits under (a) do not incur any profit (or loss) nor interest to their depositors. The law of the bank forbids all dealings carrying interest and stipulates that the company is bound by the rules and laws of Shariah in all its dealings and activities.

Deposits under (b) are rewarded if depositors choose to use their money in the bank's activities, an option which expressly means that they accept loss--if it happens--but at the same time its eventful profit. However, they are treated separately when calculating their gains owing to the technicality

of keeping the saving account which generally gives the depositor the right to withdraw on his savings at a very short notice (and sometimes without notice), and to the fact that new payments frequently replenish the withdrawals.

As for depositors under (c) they trust the bank with their deposits for fixed periods (actually for 3, 6, or 12 months and more). They agree not to withdraw their fixed deposits before the due date and entrust the bank with investing their sums in its overall activities. They are "moqarideen" participating with their money, the bank is the "active moqaridh" or partner and subscribes in the "Quiradh" with work and money.

(2.) Foreign Deposits: In order to open letters of credit in favor of its clients or of itself, the bank is bound to keep accounts with its correspondents abroad. These balances fluctuate according to the value of purchases drawn on the correspondent bank, and may well become negative for that short period which exists between paying the foreign liability and the covering transfer.

The Islamic Bank of Dubai' did not find it difficult to make arrangements with its foreign correspondents so that no interest is claimed for its credits or debit balances.

(3.) Investments: The bank is dividing its investments into two main categories: short-term not exceeding one year, and long-term exceeding one year. The short-term liabilities are invested in the following ways:

a. Importation. When a customer wants to import a certain commodity from abroad, the bank opens a letter of credit

for the full amount or part thereof depending on the client's desire. The bank becomes a "muqaridh" with the importer and enters immediately into a contractual relationship whereby it earns a percentage of the profits resulting from the sales. This is not an easy matter to agree upon, but it has been found that it works in some important cases, especially when the commodity is of standardized specifications and has world markets.

In other cases, the bank engages to buy the goods itself and enters into a sales agreement with the client. In the latter case, it has been found that it suits the majority of clients who are not themselves professional traders and those whose commodities are difficult to standardize.

b. Local Financing. It happens quite frequently that a client needs money either to purchase a durable consumer good such as a car or television or material for productive processing such as building material, raw industrial materials or real estate.

As many fixed-income clients did approach the bank to help them acquire some consumable durable article, the bank could negotiate with most of the dealers an agreement where the bank buys at a reasonable discount against cash payment--it is, in fact, cash discount plus a rebate. The bank then sells the article priced without discount or rebate and accepts payment on installments without interest.

As for those who want the financing of their purchases of productive processing material, the bank enters into a contract with the client who, generally speaking, pays the value of the

quantities required for his processing by agreed installments. Here the bank has a room for manipulation, because it may buy futures, i.e., engage to buy a specific commodity at a future specific date set at a specific price--which price could be lower than the present one. However, the bank generally prefers to buy present and fix its selling contract simultaneously.

In the third category, real estate financing, not much encouragement is given unless the customer wants the money for a short period. In practice, the funds available for real estate investments are limited to 25 percent of the paid-up capital. Most of this money has been used up in buying some lots of land within the city and some residential buildings used for accommodating the bank's personnel and for rent.

Those who apply for short-term financing for real estate purchases are required to agree to partnership with the bank. Generally, they buy to sell and if the bank management is satisfied, they participate as partners. When there is demand for financing the development of real estate projects, the bank would decide on each case on its own merits.

Personal Loans

There are two sorts of personal loans:

(1.) A poor individual-client of the bank or not--may be in need of a small amount of money for some personal need, such as marriage, medical expenses, traveling expenses. For such individuals the bank has set a charitable fund under the name of "Zakat Fund". In some cases, the amount is given as a loan to be

repaid at the ease of the borrower, while in other cases the money is paid out as aid.

(2.) But there is also the rich person who may need money from time to time in the form of a "ways and means" loan, meaning a certain liquidity to help him handle his business loan. The money would be required for unidentified purposes. Some of it may go for wages, some for paying due debts, some for miscellaneous expense. The bank's policy is to give cash in this case only to those who have been keeping accounts with it, which is quite fair. The money has been given till now in half-yearly installments and according to an agreement where the bank receives a certain percentage on his money equal to what the client realizes on profit of his total business activities. Thus, if the client at the end of the year realized a net profit of 15 percent, the bank would get 7.5 percent of his money kept for six months.

Industrial Projects

The bank has established an industrial department to study and establish some industries within the Emirate. The policy is to initiate profitable projects, to establish independent stock companies which own these projects and to participate in a good part of the share-capital of these companies. The bank may start the project and pay for the full expense of initiation, machinery and installation, and may even run the project for a short period; then it may float its shares for public subscription.

Transfers

The bank does not affect all operations of money transfer internally and externally. Against this service, the bank charges some fees.

Foreign Exchange

The bank buys and sells foreign currencies as well as gold bullion. There is the usual difference between the purchase and sale prices of every currency, which difference constitutes the bank's profit on the operation.

Bills

The bank collects the value of promissory notes and bills of exchange for the benefit of its clients. However, it has not started as yet discounting these bills and notes, even though the Azhar authorities expressed the view that such discount is permissible according to Shariah. The bank management is still reluctant to undertake such an operation as many Muslim jurists do consider it prohibited.

Miscellaneous

The bank has private safes for its clients, issues letters of guarantee as long as there is enough cover, provides different information data to its clients and would buy and sell foreign shares for their account.

Lastly, the Islamic Bank of Dubai' which started in September, 1975, has proved to be successful indeed. There are now serious attempts to establish Islamic banks in Cairo, Egypt; Khartoum, Sudan; Kuwait, Kuwait; Amman, Jordan; and Jeddah, Saudi Arabia. It seems that despite the capitalistic system which

prevails over most Muslim countries, the desire to eliminate interest is so great among the public that people do prefer to deal with such banks if available.

CONCLUSION

The Shari'ah prohibits the taking of "riba" which literally means "increase". But all increases are not prohibited in Islam. The Shari'ah has allowed increases from trading and from the loan given to a debtor. The "riba" system is very complicated that is why Shari'ah is against money-interest which was in force in pre-Islamic Arabia. Still some people think that Islam prohibits all money and all interest. It is a common belief that interest and money are the offspring and receiver of the same coin.

It is proved by various reasons that money has nothing to do in influencing the value of savings. Particularly, it is the rate of investment that determines the rate of savings. Islam prohibits interest but encourages investment. Again, we have seen that Shari'ah provides a powerful stimulus for investing and this is one of the reasons why commerce flourishes in Islam. Islam allows profit and allows partnership in which profit is not to be long is earned.

The Islamic banking will be based on the principle of partnership. Therefore, this banking system which is free of interest can help establish certain institutions on the basis of Mudharabah where capital and labor can be combined together in partnership for work. Islam has tried to bring about a compromise between labor and capital by giving the share of profit

CHAPTER VIII

SUMMARY AND CONCLUSION

The Quran prohibits the taking of "Riba" which literally means "increase". But all increases are not prohibited in Islam. The Quran has allowed increase from trade but not from the loan given to a debtor. The "Ulama" generally have accepted that by Riba is meant usury-interest which was in force in pre-Islamic Arabia. Still some people think that what Islam prohibits is usury and not interest. It is established beyond doubt that interest and usury are the obverse and reverse of the same coin.

It is found by modern research that interest has nothing to do in influencing the value of savings. Practically, it is the rate of investment that determines the rate of saving. Islam prohibits interest but encourages investment. Again, we have seen that Zakat provides a powerful stimulus for investing the idle funds. This stimulus gets momentum from the fact that Islam allows profit and silent partnership in which profit as well as loss is shared.

The Islamic banking will be based on the principle of partnership. Therefore, this banking system which is free of interest can help establish certain institutions on the basis of Muharabah, where capital and labor can be combined together as partners for work. Islam has tried to bring about lasting compromise between labor and capital by giving the whole question

of relationship a moral bent and by making moral obligations on each other as part of the faith. It is, therefore, quite possible to work out industrial, commercial and agricultural enterprise on the principle of Mudarabah combining the various units of production.

After analyzing the mechanism for Islamic banking, the problem of short-term and long-term financing was discussed. The short-term financing of industry, trade and agriculture can be made by the Islamic bank on partnership basis. Since the ordinary deposit bank has a special liquidity problem, it is recommended that the specialized credit institutions like industrial or agricultural development bank may be developed for long-term financing. Moreover, the Islamic bank may evolve the system of guarantee of loans for industries, by supplying working capital as well as equipment. This guarantee may induce private capital to move into Muslim countries.

The importance of the consumption loan is recognized. But it is recommended that such loans may be made either by people's cooperative societies or by a government credit agency in the Islamic State against the deposit of evidence of fixed assets owned by the borrowers.

The superiority of the Islamic conception of banking over modern banking lies in the fact that Islam has eliminated the tyranny of interest. Islam has prohibited interest, because it has nothing to do in influencing the volume of saving since interest makes depression chronic by retarding the process of

recovery, aggravating the unemployment problem and, finally, encouraging unequal distribution of wealth.

The Islamic economic system is often presented as a third line of thought in the attempt to understand man and his relationships with things. Its proponents believe that the Islamic approach is more moral in its points of departure and more pragmatic in its applications. The two other economic systems, namely capitalism and communism, are condemned by the defenders of the Islamic alternative as extremist to the left or to the right and hence biased in their solutions. Numerous examples may be mentioned in this regard from the historical experience of Western Europe and the United States from the time of the industrial revolution to the present. These examples will show clearly how destructive and immoral unlimited freedom can be when it is not contained within a religious framework. Similar examples of the degradation of humanity can be seen in the Soviet Union's historical experience. Due to the onesidedness of these two systems, the proponents of the Islamic solution predict that these two opposing economic systems will come closer to one another and will meet midway at a point which is that of the Islamic solution.

To prevent a possible misunderstanding some points should be noted. There is an important distinction between the economic system and the economics of emergencies such as war, severe depression or extreme backwardness, in spite of the fact that some emergencies may be long-term phenomena in the life of nations. The significance of this distinction lies in the fact

that the economic system deals with the functioning of a normal economy, i.e., with a healthy, growing society in which the economic institutions are mature. The validity of the system can be measured by the degree of achievement of its broad objectives. As for emergencies, the economic system can only give general and broad guidelines. Some of its details, modes of influence and techniques may be suspended while others may be intensified. In emergencies, the wisdom of the time and the values and directives of the economic philosophy are what are relied upon in searching for an optimum path. In this paper, the concern has been to investigate the economic system of Islam in order to present the general case for an Islamic bank, and hopefully in later works to proceed to the analysis of special cases which will bridge the gap between general economic theory and the particular conditions and problems of given countries such as development, distributive justice, inflation and economic fluctuations. This is not meant to downgrade the significance of the second kind of studies, in particular in the area of Islamic developmental theory, since these are probably the most relevant to the presently-existing situations in the Muslim countries.

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