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The Uniqueness of Islamic Economic System

In the short history of contemporary Islamic economics, we encounter two interesting phenomena: an overstatement of the uniqueness of the objectives of the Islamic economic system, and a mix up or confusion of principles and tools of analysis.

Driven by a sense of idealism, some of us attribute a special status to the general objectives of the Islamic economic system: Full employment, satisfaction of basic human needs, economic cum distributive justice, development or improvement in the quality of economic life, economic power etc. But a closer examination of these objectives indicate us that they are the same for each and all economic system as usually expressed in their economic-political rhetoric throughout the human history.

More specifically, these objectives are also the core objectives of socialism, communism, and capitalism even anarchism and all or "isms". The same also arises with regard to the institution of market, factors of production, and the principle of government intervention whereby some Islamic economists try to draw a so called "Islamic" picture that is very different from the conventional wisdom that is common to other economic systems.

This is not to deny a certain uniqueness of the Islamic economic system. This uniqueness is founded on the principles of Islam as a revealed religion as they strike a balance way of life that is not tilted in either direction. A uniqueness that lies essentially in two things. The explicit acceptance of the Divine Revelation as a source of knowledge and certain detailed pivotal institutions such as the prohibition of *riba* (interest), the private-public mix up of property/ownership, the spiritual-material mix of success, *Zakah*, *Awqaf* etc. In other words, while the general objectives and the tools of analysis of Islamic economics are the same in economics itself, some aspects of the institutional settings of the Islamic economic system are different, this system uses to reach the common goals that are not exactly the same as in other system the utilitarian capitalist which is generally given the name economics and the utilitarian communist which is dictatorial by definition.

Another important area of uniqueness of the Islamic economic system must be brought out explicitly. It is the moral characteristics of its articulation, on both the principles' level and the level of the practical rules and regulations. This moral characteristics makes a boundary of the accessible set of actions/decisions/behaviours of the economic unit. The economic unit in the Islamic system is equipped with the ability to judge possible courses of action on moral grounds, the same way one finds in all societies and systems but to this the Islamic system adds an external screen apparatus that is manifested in the set of morally-based rules of do and not to do that takes the form of the *Shariah* or the Islamic law. Some of Islamic economists call this characteristic "the moral internal and external screening". We must realize, however, that the *Shariah* based morality includes items that are not conventionally taken as moral matters such as 'pork production' but we must also realize that the contemporary moral standards of the capitalist utilitarian societies is subject to an accelerating dynamism that associate relatively to all conventional morals.

Moreover, Islamic economics also argue that because it is sourced out in the Divine Revelation, Islamic economic system is balanced in way that brings it closure to the human nature (*Al-fitrah*). Accordingly you will find in it apparent similarities to certain aspects of other economic systems because undeniably the latter are the product of human mind/experienced mix.

Consequently, it is normal that the means to reach the common goals in the Islamic economic system includes a free market exchange with emphasis on honoring consensual contracts, (some will see it as la capitalist free market), prohibition of monopoly (a la interventionism), great concern about the satisfaction of basic human needs and about economic justice (a la socialism), and assignments of a substantial chunk of natural resources to the whole societies, as represented by its government (a la communism). Add to it all the prohibition of interest that denies any rewardability to most of the purely financial transaction unless it is formed as means of production and deprives them from functionality that is conventional in the capitalist framework.

Monzer Kahf

Exclusive:

Need to Combine Islamic Economic History with Islamic Institutional Economics:

Prof. Murat Cizakca

Born in 1946, Prof. Cizakca is one of the leading faces of Islamic economics from the land of Ottoman. An author of six books and over a dozen research papers to his credit, Prof. Cizakca obtained Ph.D. in Economics from the University of Pennsylvania and has been recognized as "internationally distinguished scholar" by the Turkish Higher Education Council. He has about three decades of teaching and research experience and has presented over fifty research papers in various international conferences. He is also Member of the Selection Board, Islamic Development Bank Prizes in Islamic Economics and Banking. In an interview with Dr. Shariq Nisar, Prof. Cizakca shares his thoughts and experiences (Editor).

Emergence of Islamic economics has given a new dimension to the subject of economics Please comment.

Initially, that's during the seventies, there was hope that indeed this would happen. Some well-known western economists, such as professors Weitzman and Schlicht, had already been working on what they called "share-economics" and it was thought that application of the basic principles of share economics by the bulk of the Islamic world would provide a global boost to the idea.

But two impediments surfaced. First, some of the theoretical problems of share economics, such as the reluctance of hard working workers to share the profits they generate with those who work less could not be solved (This is not surprising, for had it been solved, socialism would not have collapsed either). Second, the principles of share economics have not been applied by the Islamic countries themselves.

Consider, for instance, the problem Saudi Arabia faced after the first Gulf war. When, after the war, Americans forced the Saudis to purchase all the military material they had transported to the region, the Saudi budget went overnight into the red. Thus, for the first time in its history the Saudi state was forced to borrow. But how was this to be realized? How could an Islamic government borrow from the public without interest? An intense debate materialized within the Saudi ruling family. Led by Prince Mohammed b. Faisal, a segment of the family was in favor of borrowing from the public resorting to the interest free instruments of public finance. For this purpose the Prince even consulted Ottoman economic historians, who were familiar with the Ottoman methods of interest free domestic borrowing. But under pressure from the American government and banks, the Saudi state was forced to borrow resorting to conventional methods. Had Prince Mohammed's vision accepted by the Saudi state, Islamic economics would have received an immense boost.

How far Islamic economics has been able to fulfill its promises and what are the major concern areas that still need attention?

To answer this question we need to look at the basic instruments of Islamic economics. What exactly are these instruments? We all talk about Islamic banks. It is as if Islamic economics is tantamount to Islamic banks. This is, of course, not true. The most urgent problem, therefore, must be first of all, to review the basic principles of Islamic economics and then identify the basic institutions, which would translate these principles into reality. A redesigning or even a process of invention of the pertinent institutions should then follow.

Concerning the fulfilling of the promises, we must face the fact that even countries such as Iran and Saudi Arabia, which declare themselves as Islamic, cannot be considered as truly Islamic economies: Saudi Arabian government has been borrowing with interest and has been quite inhospitable to Islamic banking and Iran, nor for that matter any other Islamic country, has been able to eliminate interest. Therefore, we need to look into Islamic economic history. The three great Islamic empires of the relatively recent times, the Ottoman, the Safevid and the Mughal may yield important insights. Of these the Ottoman is the most promising one thanks to the enormously rich archives that have survived in Istanbul.

These efforts should strengthen, what we may call, Islamic Institutional Economics. Much of Islamic Economics has concentrated so far on the theory, itself greatly influenced by abstract western economic theory. We even emulate the methodology of western economics and try to write essays as mathematically sophisticated as possible. In view of this, there is an urgent need to combine Islamic Economic History with Islamic Institutional Economics. We should take notice that even the Nobel committee is trying a balanced approach and granting its prizes not only to theoretical economists but also to institutional economists (Coase, North), economists/economic historians (North, Fogel, Friedman, Kuznets, Hicks) and even to social (Becker) and psychological economists (Kahneman). In short, as acknowledged by the Nobel committee, western economics is a synthesis. This is at least equally true for Islamic economics, which should encompass not only the disciplines just mentioned but also traditional Islamic wisdom such as *fikh*, *tafsir* and *kalam*. If even the western economics needs synthesis, the need is far more urgent for Islamic economics, which has its own formidable tradition.

Waqf has been your special interest area. How do you see its potential as a tool for economic development?

This question leads us directly to Islamic economic history and confirms the point I was trying to make above. You see, in order to envisage about the current potential of the waqfs, we need to understand its achievements in the past. If we look at Islamic/Ottoman economic history, we would note that throughout the Ottoman realms, the waqf, was without any doubt, the most important philanthropic institution. For six centuries, the Ottomans tried and largely succeeded to eradicate poverty through this institution. It was primarily through the waqfs that a voluntary transfer of wealth from the rich to the poor took place and the latter were fed and taken care of. More importantly, health and educational services, essential conditions for the development of human capital, were provided by this institution. Moreover, it was thanks to the waqfs that property rights violations by a powerful state were avoided; magnificent architectural heritage of Islamic civilization was financed and maintained through the centuries; urban districts could cope with the crashing tax burden imposed by an occasionally desperate state; excessive fragmentation of land could be avoided; old age and disability pensions were provided; in an age when insurance as an institution was unknown, rudimentary insurance for the members of a guild or an urban district was provided; infrastructure projects such as bridges, roads, ports, lighthouses, libraries, water conduits, aqueducts, public fountains and pavements were built and maintained; in short practically all the services one can expect to have in a civilized society, save defense, were financed, organized, built and maintained by this system. The waqfs, actually, even aided the defense effort by building and maintaining urban walls and fortresses. Finally, it was through the waqfs and the services they provided that Islam could spread first in Anatolia and then in the Balkans.

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New Books and Articles

Books:

1. ELHIRAIKA, Adam B., *On the Experience of Islamic Agricultural Finance in Sudan: Challenges and Sustainability* (Research Paper No. 63), Jeddah, Saudi Arabia: Islamic Research and Training Institute, Islamic Development Bank, 2003, 74pp.
2. KAHF, Monzer, *Sustainable Development in the Muslim Countries* (IDB Prize Winner Lecture Series No.16), Jeddah, Saudi Arabia: Islamic Research and Training Institute, Islamic Development Bank, 2003, 104pp.
3. KHAROFI, Ala Eddin, *The Loan Contract: In Islamic Law (Shariah) A Comparison With Positive Law*, Tr. Abdul Wahid Lulua, Kuala Lumpur, Malaysia: International Islamic University Malaysia, 2002, 223pp.
4. QARDAWI, Yusuf, *Poverty: Its Solution in Islam*, New Delhi, India: Adam Publishers, 2004, 228pp.

Articles

1. MANSUR NOOR, Lik A., 'Islam, the Malay World and China: Links Through the Spice Route in the Medieval Period', *Islamic Culture* (Hyderabad, India), Vol.77, No.1, 2003, pp.31-61.
2. MASRI, Rific Yunus, 'Are All Forms of Interest Prohibited?', *Journal of King Abdul Aziz University: Islamic Economics* (Jeddah, Saudi Arabia), Vol.17, No.1, 2004, pp.37-41.
3. MULJAWAN, D., DAR, H. and HALL, M.J.B., 'A Capital Adequacy Framework for Islamic Banks: The Need to Reconcile Depositor's Risk Aversion With Manager's Risk Taking', *Loughborough University Economics Paper*, 13, 2002.
4. MORONY, Michael G., 'Economic Boundries? Late Antiquity and Early Islam', *Journal of the Economic and Social History of the Orient* (Lieden, The Netherlands), Vol.47, Part 2, 2004, pp.166-194.
5. OBAIDULLAH, Mohammad, (Comment) 'Stakeholders Model of Governance in Islamic Economic System', *Islamic Economic Studies* (Jeddah, Saudi Arabia), Vol.11, No.2, 2004, pp. 71-74.
6. OBAIDULLAH, Mohammad, (Review Article), *An Introduction to Islamic Finance* by M. Taqi Usmai, In: *Islamic Economic Studies* (Jeddah, Saudi Arabia), Vol.12, No.1, August 2004, pp.55-63.
7. OSAIMY, Mahmood, H. and BAMA KHARAMAH, Ahmad S., 'An Early Warning System for Islamic Banks Performance', *Journal of King Abdul Aziz University: Islamic Economics* (Jeddah, Saudi Arabia) Vol.17, No.1, 2004, pp. 3-14.
8. SIDDIQI, M., 'Muslim Investors Find Faith in Stock Markets', *The Middle East* (London), September 2002, pp.48-49.

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Waqf ships even made the pilgrimage possible by providing a regular transport of the Egyptian grain from Suez to Mecca's port Jeddah. Moreover, all these services were provided through decentralized decision-making, i.e., not by a powerful but aloof central authority but by concerned philanthropists determined to address social and economic problems in their own neighborhood.

All of this means further that with a well functioning waqf system bulk of the government expenditure can be substantially reduced. A reduced government expenditure leads to a lower government borrowing, a reduced crowding-out effect and a reduced rate of interest. A reduced rate of interest, on the other hand, leads to higher private investment and finally growth. Moreover, cash waqfs are structurally very close to banking. Indeed, if we look at western economic history, we would note that deposit banking in the West had developed from the Italian cash foundations, *Monti di Pieta*. American economic historians have discovered direct linkages between the American philanthropic foundations in the northern states and massive capital accumulation that led to the northern industrial revolution and eventual victory of the northern states versus the South (McCarthy, 2003, ch.4). In short, there is a very serious potential for waqfs as a tool for modern economic growth in the Islamic world. But recent research has shown that with the possible exception of Turkey and India, waqfs are largely forgotten in the Islamic world. Everywhere, including Turkey, the states have replaced bulk of the functions of the waqfs with the result that decisions to provide services are taken by indifferent and often corrupt bureaucrats, quality of the state provided services are often dismal and the costs are sky high. Moreover, to finance these dubious results, the states either borrow with the consequences I have just explained or impose taxes. Taxation, on the other hand, curbs private initiative, reduces consumers' and producers' surplus and impedes growth. The situation is much more acute in the rest of the Islamic world. A thorough waqf reform sensitive not only to the formidable waqf tradition in the Islamic world but also to the achievements of this institution in the West is therefore urgently needed.

Islamic economics is said to have re-emerged in the 1970s. Being a student of Islamic history as well, do you believe Islamic economics was ever practiced before?

The first century of Islam probably witnessed the true Islamic economy. But our knowledge of Islamic economic history in this period is unfortunately very inadequate. We are probably best informed about the Ottoman economy as I mentioned above. So, was the Ottoman economy an Islamic economy? The answer is a frustrating "yes and no". Ottomans certainly were devoted Muslims and respected Islamic law. But, at the same time, they were engaged in a constant struggle of life or death *vis a vis* the entire Europe and therefore had to form a powerful state. In this, they were influenced by the Roman and Sasanid empires with the result that they deviated from some of the basic teachings of Islam, which promotes private initiative and entrepreneurship. I have described the Ottoman economy as "proto- pseudo socialist": proto because it antedated Marx by several centuries, and pseudo because rather than being based on class conflict, it promoted harmony between the classes. Our challenge as Islamic economists/economic historians is therefore to look at our own past with a critical perspective and observe where we failed. If we can do this adequately, we can then begin to attempt institutional reforms with the goal of creating modern economic systems, which can both be more loyal to the Islamic economic principles than those in the recent past and at the same time be more efficient to face the challenges of the modern times.

OPINION

In response to the article, "Where are those Islamic Banks" published in the March-April issue of the Bulletin, One of our reader has shed lights on the issues related to Islamic banking in Pakistan, particularly with regard to murabaha financing that has created controversy, for its being similar to interest-based financing, among the scholars The full response was circulated at the IBF network on June 30, 2004. We are thankful to Mr. Mahmood Shafqat for the trouble he took in commenting upon the article (Editor).

Dear Brother Shariq Nisar,
Assalamu Alaikum wa Rahmatullah

First of all thanks for sending the recent issues of *Islamic Economic Bulletin* and publishing my letter in the Jan-Feb 04 edition. Also accept my compliments for your article and review in the said edition. It is indeed important to unveil the un-Islamic practices garbed in the name of Islamic banking and this can only be achieved through dissemination of knowledge about Islamic financial instruments. For this purpose, the State Bank of Pakistan has published the Essentials of Islamic modes of Financing on its website (www.sbp.org.pk), which cover 7 major modes along with 9 model agreements. These can be helpful and concise guide for those who wish to learn about Islamic modes. The Book Review in that issue was also excellent.

I would like to offer following views on the article "Where are Those Islamic Banks?" published in March-April 2004 issue.

The article has presented some selected statements and facts, which tend to create misconceptions about Islamic banking around the world as well as in Pakistan. First of all, if someone cannot see the sun, it is not a proof that there is no sun in the universe, therefore, the blind claims of a person (whether he owns nothing or trillions of dollars) cannot be cited as a proof to the fact that there is no Islamic bank in the world (unless someone has utopian notions about Islamic banking which never existed nor is likely to exist in the future). The persons making such claims never came up with a workable model of Islamic bank as per their own notions, at least I am unaware of any such model.

The statement of respected Prince Al Waleed Ibn Talal that: "My point is there is no such thing as an Islamic bank" is seriously flawed. It indicates complete ignorance about the principles of Islamic finance. If I own a property costing to me US\$ 100 and I sell it to someone at a price of US\$ 110 repayable after one year, my profit will be US\$ 10, which will be Halal for me in the light of Holy Quran. However, if someone lends US\$ 100 repayable after one year with an addition of US\$ 10, again his income will be US\$ 10 on a loan of US\$ 100, however, as it is money lending, this will amount to Riba and would be Haram according the same verse of Holy Quran. Here net gain is the same! So if someone concludes that since the net gain is the same therefore, there is no difference between two transactions, then he needs to look at the warning of the Holy Quran which implies that the persons who say that trading is like Riba and insist on devouring Riba will rise in the Hereafter like the ones who have gone mad with the touch of Satan (Al Baqara). Please also remember that Saudi United Bank is not an Islamic bank, therefore if its former chairman is telling us that there is no such thing as an Islamic bank, then either he is trying to legitimize his service in that bank or at best represents a biased opinion. The factual position is that Islamic banks earn a *Halal* return on their financing through modes permissible by Shariah, which is comparable with the ongoing interest rates, however, as their contracts and operations are Shariah compliant, therefore, even if their profit move along the world interest rates, these will not become *Haram*.

Secondly, the proceedings of the Supreme Court of Pakistan also have not been correctly reported in the said article. Keeping in view the order of the Supreme Court, it is abundantly clear that the grounds mentioned in the article were not the basis for its judgment. Therefore, the author of the said article needs to set the record straight by presenting the true picture of the case. It demonstrates that the contention of the author that "The time is running out for the proponents of Islamic banking not only in Pakistan but all over the world...." does not reflect the true picture of Islamic banking in Pakistan as well as around the world. Islamic banking has a bright future ahead with the grace of Allah SWT, which can be seen from various initiatives taken in the Muslim as well as in countries like UK, USA, Canada, Germany, etc.

Best regards,
Mahmood Shafqat
Joint Director, State Bank of Pakistan

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