

GLOBAL NEED FOR A NEW ECONOMIC CONCEPT: ISLAMIC ECONOMICS

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One of the major hurdles in eliminating riba from the economy is the fact that there are divisions in the Muslim world regarding whether or not, modern-day bank interest is riba. The people who think that modern day bank interest is not riba usually present the argument that it is virtually impossible to have a riba-free economy. While they do not realize that the definition of Riba does not have much to do with whether we can function without it or not, as we are supposed to follow Divine decree in all circumstances, they also tend to miss out a very important consideration. The current economic system is a system made by the non-Muslims. While designing this system, obviously they did not keep into consideration the prohibition of riba. The current economic and financial system itself is based on riba and obviously will collapse if riba is removed from it. Therefore, it is time Muslims of the world design their own economic and financial system and contribute to the field of economics and finance like they have contributed (immensely!) to the field of natural science. The first step in designing this system would be to identify flaws in the current economic and financial system. Upon thinking hard, one would find out that there are several other common practices in the current economic and financial system that are contrary to the spirit of Islam. Not only that, they are contrary to common economic sense as well. This paper sheds light on such flaws in the current economic and financial system.

Introduction

There are enough resources on earth to feed everybody sufficiently. According to a recent report entitled “World Hunger: Twelve Myths” prepared by the California based Institute for Food and Development Policy, there is food in abundance in the world, so much so that in the developing world, 78% of all malnourished children aged under five live in countries with food surpluses. The problem is that many people are too poor to buy readily available food. The report says, “The true source of world hunger is not scarcity but policy, not inevitability but politics. The real culprits are the economies that fail to offer everyone opportunities”

Never was the need for a new global economic thought more pronounced than it is today. Repeated failures of contemporary economics, sometimes manifested as Latin American economic crisis, sometimes appearing in the guise of South East Asian economic crisis and very recently, reaching the beginning of its climax in the form of very self-evident global economic crisis, have themselves made it imperative that all thinking and feeling individuals question its very bases and norms. In the west itself, as evident from the quote above, voices are being raised from many quarters against the flaws in the economic and financial system.

Economics is not a natural science, where the laws of nature are fixed and unavoidable. Whether a person is a Muslim or a non-Muslim, he has to obey the laws of nature if he wants to use the forces of nature to his advantage and avoid destruction. For example, unless we follow the law of gravitation, we can not send a rocket into the space. Different points of view do not matter in the realm of natural science. The laws of natural science are determined by Allah Himself and not by man. Man has no choice but to discover them and mould his actions according to their implications.

Such is not the case with economics. Economics is a social science, not a natural science. A discipline of social science has always room for change and improvement and it can incorporate the diverse views of different schools of thought. The modern economic system has evolved over the centuries, but still that is not a guarantee that what we presently have is the only and the best form of economic system possible. Unfortunately, even the developing countries, which are suffering the most at the hands of the present economic system, have rarely questioned many of its norms, which run contrary to common sense.

The West has tried its hand at economics. The result is immense poverty amid affluence, not only in the poor countries, but also in the developed Western countries. Now it is the responsibility of the Muslims to contribute to a discipline on which their influence has largely remained dormant, with the obvious exceptions of a handful of individuals who have worked zealously to keep the discipline of Islamic economics alive.

Many wonderful discoveries in the field of science owe their existence to the enormous contributions made by Muslims of the early era, who formed the strong bases on which modern science stands proudly today. Science is vital to living; so is economics. But the tragedy is that not only have the Muslims been unable to contribute substantially to the discipline of economics, but also, they tend to blindly accept the laws and bases laid down by contemporary economics which has nothing to do with Islam. Islamic economics is not just interest-free banking, it is a complete concept of the functioning of the whole economic system, which rejects many of the norms of contemporary economics and finance.

The Case of Riba: Is There Really a Confusion?

There are many verses in the Quran having multiple interpretations but when it comes to riba, Allah does not leave a single grey area when He clearly underlines that indulging in riba is like waging a war against Allah and His Prophet (PBUH). (1) This leaves no doubt as to the banning of riba for all times to come. Therefore, even if Muslims are at a complete loss, there is no justification for not abolishing riba. Therefore it is clear, that whatever the circumstances, Muslims must not indulge in riba.

But the question is: what is riba? Unfortunately, this is the very question that has divided the Muslim scholars over the last few centuries into two main schools of thought, namely the Equivalence School and the Non-Equivalence School. According to the Equivalence School of thought, modern day interest and riba are co-equal and identical to each other and therefore modern day interest is banned in Islam. The proponents of Non-Equivalence School hold that modern day interest is distinct from the Quranic concept of Riba, which they believe refers only to the exploitative rates of interest, or usury.

We can pretend to be confused, or be genuinely confused, about riba being modern day interest. The correct way is to really make an honest effort at finding out the truth. For this we have to first see the clear injunctions in the Quran about riba. Quran gives a very clear definition of Riba when, discussing riba it makes clear that in the event of giving a loan, Muslims can only get the repayment of the principal amount, and nothing more than that. (2) If we just ponder over this ayah, we can straight away say, that whatever name you give to riba, whether you call it interest or usury, it is still riba and is haram.

Another verse that could be used to define riba is when Allah says in the Quran that, He has clearly separated profit that we earn from trade, from riba, and that those who mix the two are like people who have been led astray by the satan. (3) Thus riba is different from profit on trade. Now what is trade? Is this trade of goods, services or money?

To answer this question we must go back to our Prophet's period and find out what was generally regarded as trade at that time. We find out that, in those times trade was generally referred to the trade in goods and services. The word trade was not used for transactions involving exchanging money with money. Obviously there were no stock exchanges at that time, nor were there banks. The only transactions that involved an exchange of money with money were where a creditor lent money to a borrower and later on got that money back, charging some amount over and above the principal. But this borrowing transaction was not referred to as trade in those times. Therefore, when Quran says that profit is allowed only on trade, that clearly means trade in goods and services. One can earn profit on trade but not in borrowing transactions. Thus the interest earned in a borrowing transaction cannot be termed halal on the pretext that it is profit, just like profit on trade.

Another verse that makes it clear that there is a difference between trading in goods and services and in borrowing, is when Allah specifically mentions a borrowing transaction at one place in the Quran. In this verse, Allah instructs a Muslim to give more time to his brother in religion when he is genuinely unable to return his money in time. (4) Giving more time means waiting patiently, and obviously, does not mean charging any additional amount due to the delay. Allah goes to the extent of saying in the Holy Quran that if the borrower were facing some genuine difficulty in returning the money, it would be better if the creditor left the amount of principal altogether and treated it as a sadqa. Again, it becomes very obvious that Allah forbids us to charge anything over and above the principal. In fact, He wants us to be kind to the borrower, and not even ask for the principal amount in some genuine cases.

There is another verse, which says that Allah promotes sadqa and eliminates riba. (5) This shows that riba and sadqa are totally opposite transactions in their form and spirit. Sadqa is giving to others and sacrificing, riba is taking from the other person and forcing him to undergo suffering. Under this verse too, it becomes clearer that anything over and above the principle amount is forbidden.

If we refer to the verses pointed out in the above explanation, and try to understand their meaning deeply, it may become evident that the modern day bank interest, whatever is its rate, and by whatever name it is called, is riba.

Now, the important point is not to mix the two: the banning of riba for all times by Allah, and our ability to follow this clear-cut injunction today because the whole economic system is based on riba. As mentioned above, we as Muslims are bound to follow the injunctions of Allah even if we are at a great loss. But we must remember, Allah does not want human beings in general, and Muslims in particular, to lose or be destroyed. He wants us to be successful both in this life and in the hereafter. Therefore, there is definitely some other way in which we can follow Allah's injunctions and still be successful. We could find that way only if we do enough research and use the intellect and wisdom gifted to us by Allah to solve this problem. Allah Himself guides those who make genuine efforts in His way.

Debt Financing of Businesses

In the case of riba, some people raise the issue that there is a difference between the treatment given to commercial and consumption loans. Well, there seems to be no direct indication in the Quran in this regard. But we can make an educated guess.

In case of a commercial loan, nobody would like to lend if he is not given a reward for lending, especially when the borrower has made good profit too. It does not appear fair at all that the lender just gets the principal amount back. Islam is a religion close to nature. Therefore, Islam would not deprive the lender of his right to get something over and above the principal, and share in the profit made by the borrower with the lender's money. But by banning interest, it appears as if Allah has discouraged loan-financing for commercial purposes. It seems that for commercial purposes, equity financing is the only acceptable way of financing a business in Islam. In equity-financing, the financier gets his reward and due share in the form of profit in a pre-determined and mutually agreed ratio.

Allah has not commanded us to lend to our Muslim brother whenever he comes to us for borrowing, although He has commanded us never to charge interest. This fact leaves it to our discretion whether we want to lend to somebody or not, keeping in view that we shall receive no reward for it, even if there is a delay in repayment of the principal. Proceeding with this argument in mind, a Muslim would lend to his brother after considering at least three factors:

- 1) What is the need for borrowing? The lender could ask for his share if the "borrowing" is for commercial purposes, and participate as an equity financier. Otherwise, he could simply lend his money if he is willing to get no reward of the commercial operations. If he does not want to lend, he could even excuse himself from financing the business.

2) In case the borrowing is for a consumption purpose, this must be a genuine need, because Islam discourages wasteful consumption. Also Islam wants an individual to protect his self-respect, so that an individual will only borrow when there is a genuine need. In this case too, a Muslim is not bound to lend to his brother. He would lend out of love for Allah, for obtaining His pleasure, and to solve the problem of his Muslim brother.

3) While lending for a consumption loan, the lender could check the credibility of the borrower. If he thinks he will not get his money back, he reserves the right to refuse the loan. But if he thinks that the borrower is an honest person and nothing but a genuine problem would stop him from repaying the loan, the lender may consider to give the loan.

Therefore, it seems that Allah has discouraged us from commercial borrowing and lending and has preferred equity financing for financing a business.

What debt-financing does to the economy of a country can be seen from the many business failures and economic recession in Japan. In Japan, the businesses are usually debt financed, i.e., a major portion of their assets is financed by debt and equity financing has a smaller role. Thus, a chain reaction of business failures starts if one entity is unable to pay the debt it owes to some other entity. It becomes a drain on the resources of the other entity, which then may become unable to pay the debt to some third entity from which it had borrowed. This vicious circle then pulls the whole economy into trouble.

Economic Ills of Interest

In addition to the religious considerations, interest is bad for an economy from a purely economic point of view as well.

Some of the economic ills of interest are given below:

1) When a businessman who wants to set up a factory borrows money from the bank or from capital markets, he has to pay interest on the borrowed money even if the business is under a stressful condition and needs to retain funds, rather than paying them out as interest. In such times, an equity holder could be more considerate than a creditor, because an equity holder would only get his returns if the profit is actually incurred and the business is out of the blue.

When the lender pressurizes the businessman/business entity to pay interest even in tough times, the businessman then recovers that amount of interest from the consumers by charging a higher price for his product or service. This rise in prices further aggravates inflation. Therefore, interest plays a part in aggravating inflation.

2) Interest is a deterrent to productive economic activity. This is evident from the commonly observable fact that when rate of interest is low, economic activity increases and people are more willing to start and expand businesses, which adds positively to the economy. In contrast, when interest rates are high, people tend to be discouraged from making real investments and are more interested in saving that money and earning interest on it. This is not good for the economy because, when a small entrepreneur gets discouraged from borrowing money and starting or expanding his business due to high interest rates, the country loses out on small scale and medium sized businesses. These small and medium sized businesses are vital to a healthy economy because they provide employment to many people. They also add to productive efficiency of the economy because due to meager resources, they cannot afford wastage and inefficiency, like the large businesses can..

Since the common man cannot afford to make real investments of his own due to high interest rates, he tends to increase his income by lending to large corporations, either indirectly through banks by becoming a depositor, or directly through capital markets. These large corporations can afford to pay high interest rates. They can also get the interest rates negotiated due to their monopolistic bargaining power. This increases economic dependence of a country on a few large corporations and stifles growth of small and medium sized businesses, which are essential

for a country's economic health and also for competition. Often these large corporations are the giant multinational companies (MNCs) with huge resources at their disposal. If these MNCs come into a monopolistic position, by crushing the small industrial base of the country, it can have very bad repercussions for the sovereignty, culture and tradition of that country. Therefore interest is a hindrance in the development of small and medium size businesses, and hence, a hindrance in the healthy economic activity.

3) As explained above, by stifling the growth of small and medium size businesses, interest plays its part in perpetuating economic inefficiency and unproductivity. Also, this way, resources tend to remain in a few hands. This perpetuates inequity in the distribution of resources. So interest gives rise to both inefficiency and inequity, the two major concerns of the discipline of economics.

4) Interest rates have a component of risk premium. This risk premium is, to a large extent, based on perceptions of the investors regarding how a company will perform in the future. Since interest rates might be fixed well in advance of the actual performance of the company, a well-performing company may end up paying a higher rate of interest than a poor-performing company because the expectations with the latter were higher initially, before the actual performance showed up. So a lot is dependent on prior expectations rather than actual facts that come along later on but can have only a minimal effect. This is not the case in profit and loss sharing, where equity holders can share in the profit only after the company has performed well and has actually made a profit. This way, the profit and loss sharing system rewards the owners of the business when a business performs well, while in an interest based system, actual good performance of the business has little effect on a pre-determined interest rate.

Need For Designing Our Own Economic System

Some Muslims say that the Quran was revealed some 1400 years ago to a society, which was very primitive and different as compared to our society. But Allah himself says in the Quran very clearly that the religion is in its complete form with us. Therefore, if we are Muslims, then we must believe that whatever the Quran says is true and applicable for all times to come. Actually it is us who are not using the intellect and wisdom gifted by Allah to remove the hindrances in following His word and are taking the easy way out by saying that Quranic principles are not applicable today.

Allah is all-knowing, therefore, there must be some harm in indulging in *riba*, due to which He has strictly prohibited it. We may not be able to discover that harm at once; this may need considerable research. But once we come to know that something is as harmful to us as potassium cyanide (one dies by just putting potassium cyanide on the tip of the tongue), we shall never accept it, even though all economic experts of the world prescribe it to be the only solution to our ailment.

In the first thought, it appears that if Muslims tried to form a purely interest free society, then the economic systems of the respective Muslim countries would collapse. This fear is in fact, very true, because the current economic system is based on *riba*. Also, in addition to *riba*, the contemporary economic system has some other fundamental elements that go against the true spirit of Islam. Muslims cannot possibly be successful in trying to build an interest-free society on the weak foundations laid by the present economic and financial system. Therefore, only removing *riba* from the economy will not do the job. We must think about eliminating the other non-Islamic and nonsensical norms of the current economic and financial system.

The problem with the Muslims is that they tend to take the present exploitative economic system as their starting point when ever they think of forming an interest free society, and reach the conclusion that it is practically impossible to form an interest free society in today's times. They tend to forget that the very bases, objectives, and hence the functioning of the present economic system are unIslamic in their very nature. Unless Muslims design their own economic system by doing away with the unIslamic elements of the present system, and implement it, they can never hope to create a truly Islamic society, at least from the economic point-of-view. Blind subservience

to the contemporary economic system is like playing the game according to the rules made by somebody else, who has nothing to do with Islam.

Therefore, it is important for Muslims to design their own economic system by removing the unIslamic elements from the contemporary economic system. For that, one has to question some norms of current economic and financial system, and design alternate methods according to the spirit of Islam.

A New Approach to Solving the Problem

The efforts of the Muslim countries to create a riba-free Islamic society have largely been unsuccessful. We have a mixed system, that is, a complete riba-based system operating side-by-side a non-riba system. This allows the people who are weak in faith and character, and whose actions are largely determined by selfish interest and greed, to perpetuate injustice in society. They will borrow on non-riba basis and not disclose profits completely. A mixed system allows them to exploit the more religious and honest Muslims easily.

When Muslims who are relatively more religious and honest see such people earning much better returns than they earn under non-riba system, then, their dissatisfaction coupled with the confusion whether present day interest is riba or not, tends to attract them to the riba-based system. In a Muslim country today, riba-based transactions, which are completely against the word of Allah, are so rampant that one has to think twice if that is a Muslim country or not. This situation is no different from having many casinos, night clubs, and wine shops in a Muslim country, and the Muslim government testing the will-power of the Muslim subjects if they can or cannot avoid what is haram.

Still, we do not think of doing away with riba completely, as we do in case of casinos, because we think that economic system is based on riba. Who designed this economic system? Muslims? No. Then how can we suppose that riba is necessary for EVERY economic system to function smoothly? It is a fact that contemporary economic system needs riba, but riba is not needed at all in an Islamic economic system, which we Muslims have not yet attempted to design.

For designing an Islamic economic system, three considerations should be kept in mind:

- 1) The clear-cut injunctions in the Quran
- 2) The interpretation of relatively grey areas in the Quran according to the spirit of Islam and in the light of Hadith
- 3) Revolutionising the current economic and financial system by questioning its well-accepted norms which appear to be a hindrance in achieving the goals of economics in an Islamic society.

This paper mainly questions the different norms of present-day economic system which appear to be unfair and unproductive, and hence, create hindrances in the achievement of the goals of the Islamic economic system. To identify these flaws in the system, one needs to go into both the theory and practice of the present-day economic and financial system.

Objective of Economics

The discipline of contemporary economics is divided in to two major areas:

- 1) Positive economics and
- 2) Normative economics.

Positive economics describes the facts and behaviors in the economy. It is concerned with analyzing what the situation actually is, and then devising economic laws on the basis of facts. Normative economics involves what the

western economists call “ethical precepts and value judgements”. (6) It is concerned with what the economic environment SHOULD be like and is concerned with issues such as equitable distribution of productive resources and income, production with environmental well-being etc. The following excerpts from the book entitled “Economics”, written by Paul Samuelson (14th Edition, pg. 9) can express the “significance” of normative economics in the contemporary economic system:

“Normative economics involves ethical precepts and value judgements (like) should the government give money to the poor people?... There are no right or wrong answers to these questions because they involve ethics and values rather than facts. These issues can be debated, but they can never be settled by science or by appeal to facts. These questions are resolved by political decisions, not by economic science.”

Thus contemporary economics very conveniently throws the ethical issues under the rug of normative economics and seems to say, “Well, positive economics is too sophisticated a discipline to be involved with petty issues of ethics” .

Many of the laws of positive economics are only man-made; they are not strictly determined by nature as the laws of natural science are. These laws can always be questioned and reformulated so that they can help solve the core problems of poverty and hunger prevalent in the world today. What good are these laws of economics if they are unable to devise ways in which to allocate the scarce resources of nature to meet at least the basic needs of all the human beings sufficiently, and also to preserve these resources for the coming generations

Contemporary economics works backwards. Instead of moving from normative to positive economics, it works the other way round, in which normative economics is subordinate to positive economics. In stark contrast to contemporary economics, Islamic economics moves from the ideal to the actual situation, or in other words, from the normative to the positive economics. It first gives us the objective of an Islamic economic society, and then moves on to devise ways to transform the present situation into a near-ideal situation in both the areas of supply and demand.

What is this ideal situation? On the supply side, the ideal situation is that there should be sufficient production of the goods and services that meet at least the basic necessities of life, so that they can be available to all at cheap rates and in sufficient quantities, and also that this production is attained with minimum waste of natural resources.

On the demand side, the ideal situation is that there should be such an equitable distribution of productive resources, and hence income, that every body is able to get the fruit of his efforts and is able to afford at least the basic necessities of life in sufficient quantities. This is the underlying goal of Islamic economics and all its principles and LAWS originate from here.

If a learned supporter of contemporary economics would hear this argument, he will immediately raise this counter argument that, Islamic economics is trading equity with efficiency. That is, Islamic economics is sacrificing economic efficiency at the altar of equity, because trying to create equity is an unproductive and inefficient practice according to the prevalent economic system. From here we come to a flawed concept in contemporary economics, that is, efficiency-equity trade-off.

The Famous Efficiency-Equity Trade-Off

According to the theories of contemporary economics, an economy has to choose between efficiency in production and equitable distribution of income. The question arises: which one should be given preference, efficiency or equity? The underlying assumption is that if economics takes the trouble of being concerned about equity, people will lose motivation to work hard because: 1) they could easily earn without work,. 2) they will not get additional rewards for their hard work.

Thus production would suffer.

But Islam encourages everybody to improve his lot and increase his wealth by working hard and using all possible fair means for this purpose. Therefore, the concept of equity in Islam is very different from the concept of equity usually understood in most Western countries presently, where people take undue advantage of the safety nets provided to them by their governments. The Islamic concept of equity is different from outright charity. Even charity, or zakat, in Islam is not an end in itself, but rather a means to an end, that is, to make poor self-sufficient by helping them initially so as to give them a head start. Zakat is there to help poor people support themselves till they become so much better off that they do not need zakat. Under the Islamic economic system centuries ago, a time had come that nobody needed nor was willing to take zakat, even though he could very easily get it.

The system of zakat is there because, when a person amasses certain amount of wealth, Islam does not want him to become a hedonistic animal seeking only his own pleasure. At this point, he has enough power to help others and he must do that, instead of indulging in wasteful consumption and other negative activities.

Islam teaches the rich not to look down upon the poor, but to hold their hand and help them climb the stairs to success and wealth, so that there are no contrasting social classes, no frustrations, and no resulting crimes. A peaceful and loving society is formed under an Islamic economic system. This is because Islam stresses self-respect along with equity. That way, equity in Islam has more to do with ensuring equal availability of opportunities and resources to people to help them become better off through their own efforts and protect their self-respect, rather than with charity for the sake of charity alone.

An example that distinguishes Islamic concept of equity while preserving self-respect, from outright charity, is an event that took place in our Prophet's time. A poor man came to our Prophet to beg for alms. Our Prophet (PBUH) asked him what assets did he possess. He replied that he had one sheet of cloth and one bowl. Our Prophet (PBUH) asked the gathering of Sahaba if they would like to buy these things. Some Sahaba bought the two things. Prophet (PBUH) gave that money to this man and asked him to buy an axe, cut trees, and sell the wood in the market. This way, our Holy Prophet (PBUH) taught him and all other followers that Islam wants them to protect their own self-respect and that only comes through working to earn, not by begging.

There is another Hadith which proves that Islam condemns begging: "The upper hand is better than the lower one. The upper hand is the one which gives and the lower hand is the one that receives".

Coming back to the efficiency-equity trade-off of as put forward by contemporary economics. The argument that equity in distribution of resources and income would lead to inefficiency, is inherently flawed. In fact, it is the inequity, or concentration of wealth in a few hands, that leads to inefficiency and demotivation.

Going by a purely economic argument, productive economic resources concentrated in a few hands would lead to an oligopolistic situation and competition would be reduced, while we all agree that competition is very important for efficiency. In a capitalistic system, too much emphasis and dependence is on people who already possess capital and productive resources (one need not go into details that capitalistic system propagates unethical practices when the only concern of people is to get the possession of capital by hook or by crook). But in awarding unnecessarily high importance to the capitalists, contemporary economists forget that beyond a certain level, incentive ceases to be an incentive. It becomes a cover for inefficiency. This inefficiency today, can be seen in both the production by the rich capital owners and their consumption. This is because they can afford to waste.

Contemporary economics forgets the very basic fact of life that every human being wants to live a better life and would be willing to put in the effort to improve his lot, if he believes that there is enough justice in the system to reward his effort. There is no shortage of entrepreneurial talent. People who do not possess the productive resources now could be very intelligent entrepreneurs too and could show high productivity for their own self-interest. In fact, the Grameen Bank experience in Bangladesh and similar micro-credit experiences in other places around the world show that the very poor can be very efficient and productive. Because they have to make more

and more profit with a limited amount of money, they cannot afford wastage and inefficient use of resources. But, unfortunately, by paying minimal attention to equity and considering it a burden, the present economic system loses these highly motivated poor people to the man-made efficiency-equity tradeoff, and we are left with 20% of the people in the world possessing 80% of the productive resources and wealth, who then use the abundant resources at their disposal very uneconomically.

Equitable distribution of productive resources would itself lead to equitable income distribution that would result in efficient consumption because nobody would possess too much that could be wasted. Thus the efficiency-equity trade-off ceases to hold because equity in distribution of productive resources and consequently in distribution of income, would itself lead to efficiency in production, and also reduce wastage in consumption.

Is Inflation-Employment Tradeoff a Necessary Evil?

The inflation-employment tradeoff, as put forward by contemporary economics, ensures that some people go hungry, or remain in need of charity, in every business cycle, either due to inflation or due to unemployment. Some thought must be given to doing away with this tradeoff and building a very low or no inflation economy with full employment, instead of giving in to this, probably man-made, trade-off helplessly. To achieve this objective, it would be helpful to look into the basic cause of inflation.

Inflation is basically caused due to the gap in supply and demand for goods and services. The lower the supply as compared to the demand, the greater the prices of goods and services. This gap does not bother in the case of gold or other valuables or items of luxury which are not essential to living, but it becomes deadly when prices of items of daily consumption, which are included in the basic necessities of life, go out of the reach of a common man.

The world has been following the western economic system for a long time now and what has it achieved? Productive resources to a considerable extent are diverted towards the producing goods which although only a few people (with deep pockets) need, but can pay a lot for them, with the majority of people having their needs unmet by production, as they may not be able to pay for it. Present-day production pays very little attention to meeting the people's basic needs. Therefore, inappropriate things are being produced which are needed only by a few people. This results into inflation, because the resources that could be consumed in producing the items of basic necessities are being used to produce items of second or third degree importance, or of no importance at all, to living, thereby giving rise to a shortage of the resources to produce the basic necessities of life.

By giving a free-hand to markets, we today have hundreds of types of sweets in the market, for example, to feel proud that we have so much choice, but no basic food in the house of so many. Islam would require us to channel all our resources to fulfilling the basic needs of all. After achieving that goal, we could move to less essential items and to having a choice. Allah would not want any of his subjects to go hungry just because of the wrong planning of those in power. We must learn to give correct priorities in production, along with our concern for increasing productivity.

Making the right choices is very important. Resources should be channellised in the essential areas of food self-sufficiency, technology, and social services so that the country could make food, basic health-care, education, , basic supplies and utilities available to all. If a system was devised where supply and production would equal or exceed demand, then there would be no or very low inflation, at least for the basic necessities of life.

Therefore, the essence of Islamic economic system is that production of particularly the essential and commonly needed goods should be organised along such lines that everybody must have enough available in the market to fulfill his/her basic needs. Some body could raise the objection that with such a large population, how could supply be equal to or exceed demand. The answer to this can be given in two steps:

1) We must have belief in the fact that Allah has gifted us with enough resources to meet the basic needs of all the people in the world. Our job is to discover those resources and use them economically to our benefit.

2) We have to plan well and prioritize the production of certain basic necessities so that it can meet the basic needs of all people sufficiently. With sophisticated planning techniques and computer technology available with us today, such planning should not be a problem. Along with planning, obviously the implementation phase is of great significance, where resources have to be allocated according to priorities and productivity has to be raised, thus achieving better living standards for all, not just a select few.

Stimulating Demand and Consumption

Demand is defined as the ability and willingness of consumers to buy products and services.¹⁴ Countries use expansionary monetary and fiscal policies to stimulate demand. These measures to stimulate demand then later on result into inflation. Thus, there appears to be no solution to the vicious trade-off of inflation and employment..

Contemporary economics tends to forget that a basic level of demand always exists, especially for the basic necessities of life. The goal of economics should be to satisfy that demand, rather than forcing people to consume more and more through sophisticated and many times unethical marketing tools, and psychological tactics.

There is no place in Islam for the conspicuous consumption preached by the MNCs and large corporates around the world. They are after the consumers to consume their products, often touting that using their products would convey exclusiveness and superiority over others who do not use that product. In Islam there is no concept of exclusiveness and thinking of oneself to be superior to others. In Islam, superiority is based only on virtue, and only Allah knows how virtuous one is. Who are we to imagine, then, that we are superior, and that too, to our own Muslim brethren. Islam is not against enjoying good products and comfort, but it strictly prohibits ostentatiousness, wastage, and consumption for the sake of consumption.

The MNCs and other large corporations having huge marketing budgets are injecting the Muslim youth with the virus of self-indulgence and conspicuous and wasteful consumption. They are not only promoting a consumption culture which results into wastage of nature's scarce resources, but are also affecting our economies very adversely, by reducing people's inclination to save.

We tend to put all the blame on low interest rates due to which people are not saving, but pay no attention to the brainwashing done by sophisticated marketing tactics of large companies. These tactics are designed by heavily paid consultants, psychologists and other professionals who are experts in their respective areas and are employed by these large corporations to cash on human weaknesses.

Another example of wastage of resources in a consumption culture is the amount of money spent for marketing and advertising by the MNCs to increase the sales of their products and to fight competition. Today many huge MNCs are competing fiercely with each other. Although each one of them possesses a considerable market share and enjoys huge profitability, they are using every possible way to snatch additional market share from each other and are spending millions for the purpose. The marketing budgets of some of the large MNCs are much larger than the national budgets of some developing countries. Competition to such an extent, and that too, for many useless products, is siphoning off resources from the economy. These resources and capital could have been used elsewhere more productively.

Sometimes these expensive marketing and advertising campaigns fail, throwing away millions over trying to create shallow appeals, and adding nothing positive to the economy. The huge amount spent on these marketing efforts is then recovered from the consumers through higher product prices or decreasing product quality. Thus, in this age of consumerism, the fact is that consumers are becoming worse off in real terms, no matter what the marketing giants make them feel.

Marketing in one form or the other has always been and will always be practiced in the society (one marketing principle stated in the Quran is that the seller must let the buyer know the bad points of the product along with its good points; another point coming from Islam is to be very polite with one's customers because Islam teaches good Akhlaq to all Muslims). But it should not be allowed to waste real resources of the economy over shallow

pursuits and never ending greed to increase sales.

Therefore, in an Islamic economic system, our emphasis has to be on private saving and investment, and not on needless consumption. This is not only good for the economy today, but also helps preserving nature's scarce resources for the coming generations.

Model Devoid of Speculative Secondary Trading

Secondary trading at the stock exchanges is usually based on speculation. There is nothing wrong with secondary trading itself, but it is the speculation during the secondary trading which is undesirable. Speculation is prohibited in Islam, because it is like gambling which is strictly forbidden in the Quran. (7) But till now, very little thought has been given to banning speculation, particularly in the stock exchanges.

Stock exchanges were not present in the days of our Prophet (PBUH). The need for forming stock exchanges arose after the industrial revolution, when installing huge heavy equipment facilities required resource mobilization on a much larger scale that could not be met by a simple sole-proprietorship, partnership or joint-stock company. In the formation of such huge companies, a huge amount of financial resources is required which is then mobilized through general public.

In the society, there are all kinds of investors. Some of them may not want to, or may not be able to, commit their capital for a very long time, as is committed in the case of a sole-proprietor ship, partnership or joint stock company. Other investors may be the ones who simply do not possess the required resources to start their own business, and would like to participate in the businesses of other people to the extent of the amount that they can spare for investment, and earn returns on it. There are some investors who do not want to take up the big risk of starting their own business, but still want to invest to earn additional income. Therefore, to put it in a nutshell, stock exchanges provide investment opportunities to such people who do possess additional resources to invest in a business, but may not want to be, or cannot be, the major shareholders in it. Secondary trading provides liquidity to such "part-time" investors, and they are further attracted by the opportunity to make short term speculative gains during secondary trading.

Some of these speculations are based on truth, but many of them are generated by brokers themselves, who generate rumors to increase the number of transactions and earn commission per transaction. Sometimes, speculative trading causes stock market of a country to crash, bringing the economic activity to a halt and throwing millions out of job and forcing them to starve, even though the economic fundamentals of that country might be strong. This way, only the expectations of people, which may or may not come true, are allowed to bring real changes in the economy, thereby allowing the unreal to profoundly affect the real. Speculations are responsible for creating bubble economies. When this bubble bursts, then the common people, who had not even taken part in the "casino" activities, suffer very badly. Economic experts at such a time do nothing else than shouting loudly that an edifice was being built on imaginary foundations.

The huge amounts of money used in the stock exchanges for speculation contribute towards unproductivity and inflation. That money, time, and effort could have been used elsewhere more productively.

As long as present mechanism of secondary trading is there, people will not be encouraged to invest in shares for long term, but only to make speculative capital gains, in which one gains or loses wealth just because of difference in perceptions between the buyer and the seller regarding the share price.

The problem is with speculation, not with secondary trading which provides the necessary liquidity. A proposal to eliminate speculative secondary trading is to fix the share price of a company permanently, so that whenever an investor wants to recover his initial investment, he can do so by selling his share in the market for the same price at which he bought it. In the absence of capital gains, the main incentive to invest in the stock market would be the

profits that the investor would get in the form of dividends for the amount of time he has held the share. The surveillance of the company operations could be as strict as that done by creditors and banks, or even more, and new methods could be devised for achieving and maintaining transparency. One important point in this regard is to do away with the cover-ups built into the western designed accounting standards, which provide the business with many opportunities to fool the stakeholders.

In the absence of borrowing and interest payments, companies would be better off financially to be able to pay much more in the form of dividends than they are paying now. Since the willingness of a buyer to buy the share would mainly depend on the rate of profits that the company has historically been paying out, the company will have to perform well to incur profits and also distribute them regularly, if it is to survive in the future and raise more capital when needed. Thus if a company wants buyers for its shares, it must perform well. In the absence of interest/riba on savings, people would be willing to invest their savings in profit and loss sharing arrangement, in the company of their choice.

By eliminating speculative secondary trading, investors would be discouraged to buy and sell unnecessarily. Those who invest will invest very carefully seeing the long term potential for profit of the firm. We could have experts advising people where to invest and people also making their own efforts to analyze their investment decisions.

This model is in its very rough form and needs refinement. Some other better model may be proposed and adopted, but the point is to eliminate speculation, which is both an un-Islamic and unproductive economic practice.

The Logic of Devaluation

Devaluation of the currency of a country makes the exports of that country cheaper for foreign importers, although these exports give the same value in real terms to their importers as they were giving before the devaluation of the currency. These exports are no less valuable in terms of quality, in terms of the amount of effort put into them, and in terms of the real advantages they would give to their importers. Still they will be cheaper for their importers and contribute less to the foreign exchange of the country.

The myth is that currency devaluation is advantageous because the exports become cheaper after currency devaluation and their demand increases, leading to increased exports, thus contributing more to the foreign exchange. The fact is that devaluation of a currency increases inflation, which itself brings many other social and economic ills. Devaluation of the currency of a country is an illogical concept of contemporary economics, which is especially eating away the third world countries' economies.

In a country of strong economic fundamentals like Malaysia, it can be easily observed that erosion in the value of a currency is some times based on the whims of currency speculators. Malaysia, which had a well-educated, skilled and hard working workforce, a high savings rate, high investment rate, and high productivity rate, has suffered economic crisis mainly due to the erosion in the value of its currency brought about by speculators. The practice of devaluation of a currency has to be questioned rather than accepted blindly. A step in the right direction seems to be the fixing of the value of ringgit by Malaysia to prevent further erosion in its value, although Malaysia has been pressured by all sides, especially by the western economic experts and institutions, to devalue its currency.

The Management of Exchange Rates

In very old times, there were gold coins that had intrinsic value. Different countries had coins having different quantities of gold that determined the denomination of those coins. The exchange between currencies of different countries during trade was simply based on their denomination, or the quantity of gold that each coin of a country contained. But today, the exchange rate determination of currencies has many subjective elements. Thus a currency in which investors have higher confidence would have a higher value as compared to a currency having lower investor confidence. Such expectations of investors give an in-built advantage to countries that are already very high on the economic ladder, because obviously, a nation that is stronger economically is more likely to have better investor expectations.

This in-built superiority of a currency is further manifested in currency trading, where a few greedy individuals control the destinies of millions of innocent people of a nation, who have played no part in such trading. The trading of currencies should be banned completely. It is unIslamic as it is affected by speculation and it has economic disadvantages for the weaker nations too. Such speculations and the consequent real unfavorable changes that they bring to the economy of an economically weak nation further retard its pace of progress.

Expectations of people should not be allowed to control destinies of nations. Some other, more objective and fair method should be used to determine the exchange rates. Gold coin exchange method in old times was fairer because Allah determined which country would start off above others by gifting it with gold reserves. Later on, that country could enhance, maintain, or lose that advantage through management of its economic resources and trade.

Contemporary economics is unable to find a practical solution to the problem of exchange rate fluctuation. The respected economists of the developed world have regarded flexible rates as the most viable solution, which is also the one most affected by speculation, so it should be unacceptable to Muslims. Deep and innovative thinking is required in this area to find out a viable solution.

Holding Reserves in Dollars

Today most of the countries in the world, including many Muslim countries, hold their reserves in dollars, thus assigning the same status to the dollar and other reserve currencies, as that assigned to gold. In a world where gold is considered valuable, obviously its value will never come down substantially, although there might be some fluctuations in its value, but still it will remain valuable because people perceive it that way. Similarly, unless non-US countries stop keeping their reserves in dollars, the dollar will not lose its value substantially and the United States will remain king of the world. Thus, the strength of the dollar is a self-fulfilling prophecy; it can never lose its value like the ringgit of Malaysia did in the recent economic crisis, because many non-US countries keep its value up by holding reserves in dollars, thereby keeping its demand up and never letting its value fall down.

Dollar reserves are not the same as gold reserves. Gold is a scarce commodity whose supply and distribution in the world is determined by Allah, not by man. There are no direct political implications of holding gold reserves, except that countries having less gold gifted by Allah would find it disadvantageous. But is still fairer than holding reserves in dollars, which has direct political implications of giving dollar, the currency of another country, an in-built edge. Holding reserves in dollar also makes countries highly vulnerable to fluctuations in the US economy and the dollar rate. These countries have to adjust their economic policies accordingly, even if that adjustment is not in their long-term interest.

Europe has recognized this fact and thus it has introducing one currency for all member countries of the European Union. After the introduction of euro, major countries of Europe may not want to hold dollars, but their own currency euro, in reserves, and may gradually have their non-EU trading partners do the same. If this happens, then dollar would be reduced in its value as number of nations demanding it for reserve and trade purposes will decrease substantially. This will make dollar less valuable.

Therefore, we can never get rid of the hegemony of dollar or other big currencies in the world, and hence the hegemonies of their respective economies, unless we refuse to hold them as reserves. Some thinking is needed in this area by Islamic economists.

Deficit Financing Through Debt

Islam does not seem to encourage us to take debt. As Muslim individuals, we are asked to live moderately and remain within our means. So we would rather not borrow unless there is a very genuine need. Borrowing would be even more strictly forbidden in the case of a sovereign Muslim nation, particularly when it borrows from non-Muslim nations. Apart from making never ending interest payments on foreign loans, which reduces our developmental budget, there is another down side to incurring foreign debt. A nation that borrows remains under obligation and cannot remain sovereign for long due to its dependence on other nations that could get their unjust demands

accepted in return for giving the loan. We can find clear examples in today's economic environment in this regard. Budget deficits also give rise to another problem, i.e., inflation.

Incurring national budget deficits has become a sort of necessary evil, and, a taken-for-granted practice. Usually government budgets are prepared by starting from the expenditure side. After the expenditures are decided upon, the difference between needed and available resources is determined. If there is a gap between the revenue and expenditures, which usually is there, then the most common method for covering this gap is employed and that is, incurring debt. This debt, local or foreign, is usually incurred with complete disregard to its long term viability. The borrower country usually ends up incurring new debt to repay the old one, with the debt-servicing burden constantly on the rise.

A new approach to budget making is needed. While making a budget, a government should first determine the amount of revenue available with it. Then it should prioritize its expenditures keeping in view the revenue that could be generated to meet these expenditures. It need not be repeated again what should be the priorities of an Islamic government. Thus, a government must use its own resources and use them efficiently so as to be able to live within its means.

Alternative methods must be found to fund huge developmental projects. Sometimes an emergency arises when there is an urgent need for capital mobilization. That is an exceptional case and some method must be devised for that other than deficit-financing.

Winds of Change

The world is becoming weary of the instabilities, inflation and poverty that are a gift of the present economic system. Islam gives us an economic system for sustainable development. Slowly and gradually, without realizing it, the world is moving towards discovering the concepts that form the bases of Islamic economics. A case in point is introduction of euro and the five convergence criteria for the European countries, to become a member of the euro-block.

European union, if not disturbed by political factors, will mark the beginning of a new economic era of stability and growth. The five convergence criteria which every member of the European Union is bound to follow are stability oriented. Four of these criteria require member countries to have a low average annual inflation rate, low long term interest rate, low government budget deficit and low government debt. Introduction of the new single currency for the region, Euro, may also remove many economic inefficiencies related to exchange rate uncertainties between economies of the region, giving rise to increased investment and production. Low interest rate will cause the inflation to be low. Reducing budget deficits and making budgets in which expenses would be met by largely by revenues, will lead to low government debt, which would result in low inflation. These convergence criteria are themselves a shift towards Islamic economic concepts, although a very slight and indeliberate shift.

Conclusion

Voices are being raised from various quarters in the world against the flaws inherent in the contemporary economic and financial system. Eventually, the system would undergo changes, but it will be a painfully slow process. Muslims should expedite this change, not only because they possess the required knowledge in the form of Islamic economic principles given by the Holy Quran, the Hadith and derived from the spirit of Islam, but also because they have the responsibility to do so to attack one of the greatest evils mentioned in the Quran, namely *riba* .

Muslims have already wasted a lot of time and have suffered immensely at the hands of an illogically and unfairly designed economic and financial system, which is unIslamic too. This paper has put forward broad guidelines for designing an Islamic economic and financial system. Some of the solutions proposed may seem radical and im-

practical, but this is a vision for the 21st century and beyond, and we have to move towards it in steps, although as quickly as we can. These guidelines are open to constructive criticism and discussion, because we need collective efforts to face this formidable task, and the efforts of just one individual or one mind cannot be enough. Applying logic, wisdom and common sense to Divine commands and finding out their inherent principles will also help us to come out with practical ways to implement them in today's changed times, with their inherent principle remaining the same as give by Islam.

The Muslim Ummah is huge in terms of geography and very rich in terms of resources. When a small and resource-less country like Japan can make other countries accept its terms, then there should be no limit to the power of Muslim Ummah.. We can make the non-Muslims deal with us on our terms. For that, we require to decrease our dependence on non-Muslim countries and try to be as self-sufficient as possible through unlimited cooperation between the Muslim countries. Increasing trade with each other could be one good step.

We Muslims must put an end to our blind subservience to the economic system designed by others in which we are playing the game according to rules made by someone else. We treat these man-made rules of economics as nature's law, while forgetting the economic laws given to us in the Quran, sometimes as explicitly as in the case of interest and sometimes subtly. Once we make up our minds to discover these Divine laws of economics, and prepare ourselves to face all hardships in the process of implementing a system based on these divine laws, Allah Himself will guide us to the right path, and issues that appear confusing or impossible today, will themselves become clearer and possible. The pre-condition is to make genuine efforts in the right direction.