

Abdul Hasan M. Sadeq, Ataul Huq Pramanik and Nik Mustapha bin Hj. Nik Hassan (editors)

Development and Finance in Islam,

The Islamic University Press, Kuala Lumpur, 1991, 279 p.

and

Abdul Hasan M. Sadeq (ed.)

Financing Economic Development: Islamic and Mainstream Approaches,

Longman Malaysia, Kuala Lumpur, 1992, 239 p.

Reviewed by:

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I

The first book presents the papers and proceedings of the International Seminar on "Islamic Thought: Current Issues and Challenges", held at the International Islamic University, Malaysia during July 1987. The papers presented covered the following areas: Historical and Ideological Basis of Islamic Economics, Development in Islam, Financing Development in Islam, Some Special Aspects in Economics and Business and Case Studies.

The second book contains a series of papers which narrowly focuses on financing economic development in Islam and contrasts the same with the mainstream approach.⁽¹⁾ It presents papers primarily in the areas of consumer behavior, savings and investment behavior, sources of financing development and resource mobilization from a development perspective. The remaining papers on public finance and financial systems study financing the economic development.

(1) The mainstream economic development via domestic and foreign sources are discussed by A.P. Thirlwall and not elaborated in this review.

II

M. Nejatullah Siddiqi fires the first salvo in the first book by discussing the *historical basis of Islamic Economics* in his paper: "Islamic Economic Thought: Foundations, Evaluation and Needed Direction". The contribution of various Muslim scholars such as the *fuqaha* (jurists), *sufis* (saints) and philosophers are summarized under four phases. The emphasis of the scholars in the foundation or the first phase was to lay the groundwork of social and economic behavior of human being from the guidelines of the Shariah (Islamic Law). That of the scholars in the second and third phases was to conceptualize problems pertaining to public finance, trade, money and banking, population, incentive system, distribution of income and role of market from a macro-perspective. The current phase is the most challenging one as the Muslims are recovering from the harrowing experience of colonialism which enslaved them both physically and intellectually. To revive our value system under the current *ribawi* (usurious) system amounts to doing *jihad* (struggle against oppression) intellectually with the critics of Islam.

The issue of ideological basis of Islamic Economics is adequately discussed by Syed Othman Alhabshi in his paper: "The Role of Ethics in Economics and Business". He introduces the concept of *tawheedi* (belief in the oneness of a Supreme and Almighty Allah) paradigm which requires justice as a guiding principle. This promotes well-being of human-kind in all spheres of economic activity and helps in prevention of *fasad* (scuffles) and *zulm* (oppression).

III

The *crucial role of public expenditure in invigorating* growth in an Islamic state is further elaborated by M. Nejatullah Siddiqi in the second section of the first book which emphasizes development in Islam. He draws upon the injunctions of the *Quran*, the *Sunnah* and the practice of the four rightly guided *Khulafa* to outline the first category of duty of the Islamic state i.e. fulfillment of basic needs of society such as defense, law and order, *dawah* (propagating Islam), *al-amr bil ma'ruf wanahi anil-munkar* (inviting people to do good deeds and avoid evil), civil administration and fulfillment of social obligations that the private sector fails to fulfill. Next, Siddiqi resorts to the second category based on *ijtihad* (logical reasoning) of our scholars. This includes any expenditure necessary under present circumstances such as protection of environment, supply of necessary public goods other than those listed earlier, scientific research, capital formation, subsidies for certain essential private activities and expenditures necessary for stabilization purposes. Finally, he cites a third category of expenditures based on the process of *shura* (consultation). The paper concludes with an emphasis on an efficient fiscal distribution system to: avoid *israf* (extravagance), minimize free rider problem where people depend on welfare handouts, maximize growth potential with an incentive to save. This paper answers a very vital question that a *hakim* (Muslim ruler or government) cannot tax for purposes other than those mandated by the Shariah or necessitated by the social obligation (*fard kifayah*) without the willing consent of the people.

Abul Hasan M. Sadeq presents a well-written paper, which clears up many misconceptions that Western scholars have on the concept of economic growth in an Islamic economy. Sadeq defines this as a "sustained growth of a right kind of output that can add to human welfare". He elaborates on how Islam provides incentives for economic growth by resorting to the *Quran*, the *Sunnah* and some examples of the *Sahaba* (the companions of Prophet Muhammad). The major determinants of growth are investible resources, human resources, entrepreneurship and technology. The paper concludes with an emphasis of the essential role of Islamic state to formulate policies to enhance growth for the fulfillment of the needs of the *Ummah* (Muslims). This growth, in the view of Sadeq, not only increases human welfare in this world but also in the hereafter. The only problem in this paper is the numerical example which may be difficult to generalize because of assumptions of exogeneity of interest rate and profit sharing (*mudarabah*) ratio.

In the second book, Sadeq elaborates further on economic development in Islam by extensively discussing the domestic sources and external sources. The domestic sources comprise the private and public sectors. In the private sector funds are raised via profit and loss sharing accounts of Islamic financial intermediaries. The public sector plays a vital role in the poverty eradication and the process of general welfare of the public by optimally utilizing *zakah* (poor due) and other forms of taxation. The section dealing with taxation from the shariah perspective is very enlightening. The external sources of development finance comprise international grants, foreign loans and direct foreign investment. Grants are preferred over other sources as they need not be paid back. However, there may be some strings attached from the donor. Loans from foreign government/ agencies or international agencies may be *ribawi*. There may be conditions attached which force the recipient to purchase goods/ services at exorbitant prices. Thus foreign aid either in the form of grants or loans may not be contributory in nature. Sadeq further goes on to emphasize an important external source i.e. cooperation among Muslim countries for development. Sadeq, in a third essay, discusses the issue of mobilization and utilization of all domestic and external sources in order to reach an optimum potential. The technical issues of development are demonstrated by (a) Monzer Kahf, who presents a micro-economic model of savings and investment in an Islamic economy where *ribawi* loans are not permitted and *zakah* is imposed and (b) Fahim Khan, who models consumption behavior in Islamic economy and draws conclusions on savings, growth and income distribution effects by performing numerical simulation of the model.

IV

In the section on Financing Economic Development, Murmwar Iqbal explains economic development as a matter of improving the living conditions of the people. He enumerates the different economic indicators and concludes statistically the poor state of development of Muslim countries. He further analyzes the requirements of revitalizing the economy by utilizing either domestic resources (including savings, taxation, monetary expansion) or external sources of financing (such as external borrowing, foreign aid, foreign direct investment) and the limitation of each of these sources. Iqbal concludes the paper with the role of financial institutions and

instruments in the development of an Islamic nation. He particularly delves into replacing the *ribawi* financial system by an equity participating one. Although, I subscribe to this view, I feel that Iqbal's blank statement on the efficiency and stability of a profit-loss sharing banking system over that of a *ribawi* one needs to be backed by a rigorous theoretical / empirical investigation.

The following paper by M. Umar Chapra focuses on the structure of an ideal Islamic financial system. Chapra focuses on the structure of an ideal Islamic financial system. Chapra argues about the comparative efficiency of the Islamic financial system vis-a-vis the *ribawi* one on grounds of distributive justice, financial health and stability and optimal resources mobilization. He next discusses the shape and role of various financial institutions such as the central bank, money and capital markets, commercial banks, deposit insurance and loss-offsetting reserve, socio-economic justice through financing, risk and expense, auxiliary institution and the stock market. Finally, Chapra concludes by delving into the design of financial instrument. Although, I am not a fan of the *ribawi* system I find it difficult to accept some of Chapra's argument such as those based on the erratic movement of stock prices or interest rates in the West. One can explain these dynamics by resorting to the standard general equilibrium analysis incorporating various forms of heterogeneities such as differential information on wealth or taxes.

The last paper in this section analyzes whether Islamic banking is at a crossroad. Ziauddin Ahmad first traces the current history of Islamic banks and discusses the aims and objectives of the Islamic banking system. That is, promotion of growth best suited for the eradication of poverty, equitable distribution of income and wealth and creation of sufficient opportunities for gainful employment. He further elaborates on various forms of Islamic contracts such as *Mudarabah* (profit-sharing) and *Musharakah* (corporate-equity participation) and criticizes one which is borderline Islamic i.e. *Murabaha* (mark-up). Ahmad points out that Islamic banks have grown in assets and that Western banks are also following their lead in offering similar services. Yet, the assets of Islamic banks are concentrated on these borderline *Murabaha* transactions. Also, they contribute very little to the essential areas of agriculture and small scale industry. Islamic banks need to revamp their pattern of business in order to be more in line with the spirit of Islam. This honest assessment, in my opinion, is the major contribution of Ziauddin Ahmad.

In the second book, F.R Faridi and Umar Chapra discuss public finance from different perspectives. Faridi discusses the basics of capital accumulation, economic growth from a conventional viewpoint and reinterprets it based on policy formulation and making of a budget in Islam. Chapra, on the other hand, reinforces the view of reforming public finance system in Muslim countries into efficient system conforming with the goals of the *sharia'h*. He discusses the current inequities of taxation and recommends the design and implementation of a just and efficient taxation system. On the spending side, he argues against various modes of *israf* such as corruption, inefficiencies and wastage. He is of the view that an Islamic government be lean and should shed low performing state enterprises, restrain high defense spending and

deficits. He advises financing deficits Islamically with *ghair-ribawi* (non-usurious) mode of financing. This is a very enlightening paper as Chapra points out certain areas which need public support such as educational institutions, hospitals, housing schemes for the poor, orphanages and other social service projects. He recommends that Muslims should revive the institution of *awqaf* (charitable trusts) to take care of the above areas of necessities.

The final paper in this section is presented by Abbas Mirakhor, who discusses the theory of an Islamic financial system, which incorporates *ghair-ribawi* transactions which enhance the stability of the financial system, savings and efficient resource allocation by financial intermediaries. It is an excellent article, where he strikes a chord with me when he discusses the vital role played by the stock market.

V

In the special issues of economics and business Monzer Kahf argues on the importance of *ijtihad* on the unresolved areas of *zakah* in our current situation. He is of the opinion that the intention of *zakah* in the *Quran* and *Hadith* (traditions of Prophet Muhammad) was to achieve distributive justice. At the present there are different forms of wealth, which should be subject to taxation. Since the relative prices of goods (particularly that of gold to silver) have changed from the times of the *Sahabah* (illustrious companions of Prophet Muhammad) the *nisab* (minimum level of wealth) of *zakah* needs to be reconsidered. The rates of *zakah*, similarly need to be looked at to ensure justice. The last two issues are very controversial. It could be interpreted as *bida'h* (innovation) as we cannot tinker with the established rules in the *Sharia*. A better way would be to encourage Muslims to give extra *sadaqah* (charity) on the top of *zakat-ul-mal* as enjoined in the *Sunnah* of Prophet Muhammad and elaborated by both Chapra and Sadeq in the second book. Kahf finally suggests that the Muslim state should design efficient measures of collecting and distributing *zakah*.

The following article by Muhammad Akram Khan provides a critical overview of the current practice of trading in commodity, currency and corporate stock markets especially in the West. It is a controversial article, as according to him, trading in forward market is *halal* (permissible) while that in the futures market is not. The only difference I find in the two types of contract is that futures market is standardized and more marketable, while the forward market is more tailor-made and less marketable. In the spot exchange market, Mr. Khan's opinion is that the transaction between two parties should conclude instantaneously. Due to physical separation of buyers and sellers and due to book-keeping and verification constraints, instantaneous transfer of goods or foreign exchange or even certificates may not be possible. Although Khan mentions the possibility of creating a *ribawi* transaction via a currency swap, he is not aware of the existence of it via hedging using the forward and spot markets simultaneously. In the area of stock market, he is of the view that the only permissible securities are the *mudarabah* and *musharakah* certificates. He correctly frowns on margin loans to purchase securities as it is based on *ribawi* loans. However, he makes no mention of 'short' selling which is not permissible as this sale is by one who does not own the shares. Akram Khan also believes that in an Islamic economy options on

stock should not be allowed based on his interpretation of the *hadith* on ‘*urbun*’ sale. This is not correct as normally the price of an option or the premium is not used as part of the purchase price (if this were the case, it would be construed to be an ‘*urbun*’ sale). Khan concludes his paper by emphasizing the evaluation of intrinsic value of *mudarabah* and *musharakah* securities to convey information to the financial markets. It is an irony as in most Western countries such as the U.S.A. public information is encouraged. There are government agencies such as the Securities and Exchange Commission which serve as a watch-dog to curtail any abuses by the privileged few. Moreover, an accounting book value akin to Khan's intrinsic value is reported along with a financial analyst's view of the security's worth based on discounted cash flows. What I feel important in an Islamic economy is an emphasis on economic justice.

VI

The last section focuses on the issues of *zakah* administration and Islamic banking from a Malaysian perspective. Nik Mustapha Hj. Nik Hassan in his paper: “*Zakat* in Malaysia: Present and Future Status” is very critical of the status of *zakah* in the current Malaysian system. He is of the view that currently it has no place in the Malaysia's economic or financial system. Thus, the outcome of this is that the true potential of *zakah* is not being realized. He recommends that the *zakah* system in Malaysia be reconstructed in two stages: transition stage and implementation stage of a comprehensive Islamic system. In the transition stage, the government needs to centralize the *zakah* institution at the federal level, incorporate *zakah* policy in the country's fiscal system and educate the public about the significance of *zakah*. The ultimate objective of the comprehensive Islamic system is to realize the welfare of both the Muslim and non-Muslim citizens of Malaysia.

The final article by Zakaria Man entitled: “Islamic Banking: Prospects for *Mudarabah* and *Musharakah* Financing”, is very critical of Bank Islam Malaysia Berhad (BIMB). He traces out the history of BIMB and feels that it was created due to the pressure by Muslims. However, it was established by those trained in the *ribawi* commercial system. Thus, the emphasis of BIMB on short-term asset financing contracts such as *Bay' Mu'ajjal* (deferred sale) and *Murabaha* are the prime source of its deficiencies. Zakaria Man recommends that BIMB beef up its long term equity financing contracts such as *Mudarabah* and *Musharakah* to promote long term growth of Malaysia.

In general, I find the books to be informative. They have articles from renowned Islamic economists, some of which are truly enlightening. The first book is highly descriptive and non-technical in nature, while the second one is complementary to it as it presents some rigorous analysis. The books provide a broad view of current ideas of Islamic economics and a critical assessment of where we stand. We need to use this for improvement in the following ways:

(a) Muslim countries need to attract capital via direct foreign investment. This source of external financing was briefly mentioned by Sadeq. This can be fostered by political stability and an independent judicial system which safeguards the rights of individuals,

institutions and promotes growth.

(b) The Muslim world needs to reinforce education as the state of the *Ummah* is very pitiable. We are not aware of our rich heritage as our education is very Euro-centric. Furthermore, various cultural things have impacted our lives that we cannot identify the real Islam from *bida'h* (innovatory) practices. In order to reach the true potential, every Muslim should be imbued with the *Quran* and the *Sunnah* of the Prophet. We should be made aware of the *tariqah* (way) of the *Salaf-Saliheen* and of other good Muslims which followed their path. For example, the tone of some of our scholars in Islamic economics is more towards socialism. This runs counter to the view of *Sheikh-ul-Islam* Ibn Taimiyah who is of the view that in Islam the government should not interfere with the markets except in extreme situations.

(c) The Islamic economics literature discusses the special role of *zakah* in Islam. But our *zakah* collection, administration and distribution is still in a rudimentary stage as correctly pointed out by Zakaria Man. We need to excel in taking care of our needy in a way better than the West.

(d) We need to do *ijtihad* on the issue of *takaful* (insurance). Unfortunately, there is no discussion in both books on this essential element in a nation's economic growth and welfare.

(e) The concentration of assets of banks in *murabaha* accounts points to the rudimentary nature of secondary markets in the Muslim world. In general, financial intermediaries face a maturity mismatch of assets (*ghair-ribawi* loans/ participation agreements) and liabilities (deposits). If the stock markets are sufficiently developed, the assets of Islamic banks can be easily securitized and used to raise cash in a credit crunch. Mirakhor, in the second book, rightfully calls an Islamic bank as a 'mutual fund'. Furthermore the short-term focus of Muslim investors is due to political instability in Muslim lands and a corrupt judicial system. This needs to be improved upon.

(f) There is need to do *ijtihad* in the area of design of *ghair-ribawi* securities. Chapra barely touches this vital issue in his paper in the second book.