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Monzer Kahf

The Islamic Economy:
An Analytical Study of the Functioning of the Islamic Economic System,
Plainfield, Indiana: The Muslim Students' Association of the
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Dr. Kahf is one of the prominent Muslim economists writing today on Islamic Economics. His contributions have been generally thought- provoking. *The Islamic Economy* is another constructive addition by him to the increasing volume of literature on this subject.

Dr. Kahf argues in the introduction to his book that most of the available literature on the economic system of Islam is primarily descriptive and very little has been written to "interrelate the different facets of the Islamic economic system" to form "one whole theoretical structure that is internally consistent and externally valid". Hence his undertaking to show how this economy works, how its major variables are determined by Islamic injunctions and how the system is able to achieve its major objectives within the framework of general equilibrium. Dr. Kahf has rightly pointed out that the validity of any economic system can be tested by "its internal consistency, its compatibility with the principles organising the other aspects of life and its provision for improvement and growth". The objective, although extremely difficult, is no doubt laudable and it is perfectly understandable if, within the span of a little over a hundred pages, Dr. Kahf has not been able to carry his analysis far enough to show how the Islamic economy would be able to realise its major goals and avoid the excesses of the Capitalistic system.

While discussing the "theory of consumption", Dr. Kahf explains the concept of `goods' in the context of Islamic teachings (p.23) and then briefly states the ethics of consumption in Islam. However, he does not carry this discussion further to drive the "theory of consumption" in Islam and to lay down some guiding principles to serve as the basis for the next chapter on the "Theory of Production". It is the implications of the Islamic theory of consumption which would have helped in constructing a theory of production and suggesting policy measures to ensure a pattern of production which, as he has briefly indicated, is morally oriented, equitably distributed, and fully utilises the God-given human and natural resources (pp.31-32). Consequently, the discussion remains as descriptive as it is in the existing literature and fails to show within "the general equilibrium framework", the role and limitations of "market structure", "economic freedom", "cooperation" (as against unhealthy competition), and Government intervention in the realization of Islamic objectives.

The essential contribution of the book to Islamic Economics lies in Chapter Von "Macro-Monetary Theory", where Dr. Kahf has used the tools of economic analysis to demonstrate the effects of *zakah*, prohibition of *riba*, and *al-qirad* (*mudarabah*) in the realization of Islamic objectives. He has tried to show the economic effects of *zakah* on consumption and saving/investment decisions and the distribution of income and wealth. He has demonstrated that *zakah* would help divert "every bit of wealth into productive activity" (p.63).

Howe',er, two of his propositions do not seem to be valid. Firstly, he has argued that owners of wealth would keep on investing until the marginal profitability of investment becomes equal to *zakah* after which the owners of wealth would prefer to increase consumption rather than hold idle wealth (p.60). This would happen only if the income earner is faced with an incumbent choice between consumption and saving. Although this may sometimes be true, there are also cases where a person saves because he has fulfilled all essential needs and does not wish to expand his luxurious consumption due to value preferences or a specific goal in terms of saving. Dr. Kahf has no doubt recognised this on p.81, where he states that "Saving is a positive activity and people are disposed to save for the sake of saving". If the saver continues to save he would prefer to invest as long as there is some positive rate of return so as to offset even partly the effect of *zakah* on his wealth, compared with the holding of idle wealth, in which case 2.5 percent of it would be depleted by *zakah*. This would be particularly so if the saver treats *zakah* as a spiritual obligation rather than a cumbersome tax.

The second point to be disputed is the statement that *zakah* collections during a given year must be spent in that year (p.65). Although this is in conformity with the view of some jurists, it should be perfectly permissible to use *zakah* outlays for compensatory financing as this would better serve the interests of the *Ummah*. If in a full employment year, the number of *zakah* recipients is less, why shouldn't the left-over amount be saved for a year when the rate of unemployment or natural calamities is higher.

Like some other Muslim economists, Dr. Kahf believes that in the interest of a saner monetary system it is necessary to prevent commercial banks from "creating" money. Creating money, whether in the form of currency or of deposits, should be the sole privilege of the Islamic state. This means a 100 per cent reserve requirement for commercial banks. Commercial banks would hence not be lending institutions, and the lending or investing function would be performed by finance houses and the *zakah* Fund. Dr. Kahf has completely glossed over the question of how the expenses of commercial banks will be met. Will they depend entirely on service charges or will they be subsidised partly by the state. He has also not attended to the question of how it will he ensured that the finance houses do not "create" credit particularly if the finance houses and commercial banks are merged and do not operate as independent institutions (p.76).

The *zakah* Fund, according to Dr. Kahf, will be the institution responsible for creating credit. This is not an appropriate function for the *zakah* Fund. He further proposes that "monetary credit" should be extended free of charge in the form of *qard hasan*, in which case the *zakah* Fund would get no return, whether in the form of interest or a share in profit. This whole section is very sketchy and difficult to understand. He has not discussed the question of how much new money will be created by the *zakah* Fund, and how, or on what bases, it will be distributed among the users. If the *zakah* collections are used to finance essential consumption of the poor and the newly created money is used to finance productive investments, even though of small businesses, one fails to understand why this credit should be provided as *qard hasan* depriving the state of the seigniorage and the profits on newly created money, Moreover, if the commercial banks are to be deprived of the privilege to create deposits, it would be best to confine this function to the central bank, which is the only institution having the technical ability to determine the extent of new money to be created to finance the growth of the economy without inflationary excesses. The central bank can then determine how much of this created money should go to the government or the *zakah* Fund.

The language could have been made more clear and lucid and printing errors could have been avoided.

On the whole the book is a valuable contribution to the literature on Islamic economics and its Chapter V could serve as a useful aid for teaching Islamic Economics at the University level.