

Islamic Economy

By

Dr. Mohsen A. El-Guindy

Contents

	Page
Introduction	3
The Capitalist economic system	4
The Islamic economic system	10
Instruments of the Islamic economy	20
Resurgence of the Islamic economy in modern time	27
The Islamic economic system is under attack	31
References cited	42

Introduction

The Islamic economic system has been strongly criticized by some western economist for its alleged incoherence, incompleteness, impracticality and irrelevance driven by cultural identity rather than problem solving. The false accusation reached to the extent of maliciously claiming that Islamic economics does not go back to the Prophet of Islam but is an invented tradition that first emerged in the 1940's.

The ugly separation of the criticizers from historical literature makes their accusations erroneous, unscientific, and unacceptable.

The criticizers deliberately neglected the well documented historical facts regarding the greatness of the Islamic economy with which the Islamic Empire stretching over the Arabian Peninsula, most of Africa, South of Europe and large parts of Asia, has managed quite successfully to rule for hundreds of years. The criticizers deliberately neglected the fact that the Islamic economic system which proved successful for 800 years is essentially a capitalist one, and is the father of the present capitalist system.

The author provides evidences showing that the origin of capitalism and free markets can be traced back to the golden age of the Islamic Empire. The outstanding contribution of Islamic economies throughout the ages to the present conventional economy is emphasized.

The author reports many concepts, techniques, and instruments of Islamic finance which were later adopted by European financiers and businessmen.

The present financial crisis is a manifestation of the defects of the present capitalist system. The author explains the maladies of the capitalist system and the disapproval of eminent western scholars of such a system.

The author shows that when the financial crisis worsened, no Islamic financial institute has declared losses in the financial securities and bonds that were a major cause of the crisis. On the contrary, many Islamic institutions have announced an increase in profits, which resulted in many commending the principles upon which the Islamic banking is based, and the Islamic laws that regulate it, calling for its introduction to rectify the global financial system.

The powerful resurgence of the Islamic economy in modern time is emphasized.

Chapter 1

1- The Capitalist economic system

I read several articles investigating Islamic economy. They all tackled many important issues distinguishing Islamic economy from other contemporary economies. I was however overwhelmed by the article presented by Dr. Muhammad Malkawi entitled "Economic Justice: Islam versus capitalism" (1). The following is a concise summary of his constructive and informative article.

Capitalism, the economic system now dominating in several parts of the world, deals with man's needs and the means of satisfying those needs. It addresses the materialistic side of man's life and it is established on three principles: 1) relative scarcity of commodities and services in relation to needs 2) the economic value of a product 3) the price and its role in production, consumption and distribution.

Man has needs that require satisfaction, so there must exist the means to satisfy them. These needs are purely materialistic, such as the need for food, clothing, medicine, education, and security. As for the moral needs such as pride and honor, or spiritual needs such as the sanctification of Allah's will, they are not recognized economically, and are therefore disregarded and have no place in economic studies (1).

Commodities and services are the means of satisfying the human needs. Since the need means the economic desire, then an economically beneficial product is anything desired whether it is beneficial or harmful. Products may be considered beneficial from an economic viewpoint even if the public opinion consider them harmful. Thus wine, tobacco, drugs, guns are beneficial things since there are people who desire them. Stocks, interest rates are also beneficial as long as there is someone who would benefit from their use.

As such, capitalism does not concern itself with the nature of society but rather with economic commodities as means of satisfying human needs. Therefore, the capitalist economic system primary function is to provide the means of satisfying man's needs, irrespective of any other consideration.

Capitalism recognizes that man has basic needs which must be satisfied, and needs which increase in number as man proceeds to a higher level of urbanization, a goal that cannot be fulfilled no matter how much commodities and services are produced. The inevitable consequence of such system is that some needs are either partially satisfied or not satisfied at all.

The Capitalist economy views man as a purely materialistic creature with no relevance to his spiritual needs, ethical thoughts, and moral objectives. Capitalism does not give weight to any value except to the material value of the product and the material nature of the human need. Under Capitalism, feeding a poor (wealth distribution) may be done only if it brings a material benefit, such as tax break. But it will not happen in response to an order from Allah or in pursuit of Allah's pleasure and satisfaction.

The exchange of resources and efforts among people creates relationships among them, based on the structure upon which the society is formed. Thus, viewing the economic commodity as a means of fulfilling a need without caring for the belief of the society and its inherent internal structure violates a fundamental rule of society structure. Therefore, it is incorrect to consider a thing as beneficial just because there is somebody who likes it, whether it is harmful or not and whether it affects the relationship among people or not, and whether it is prohibited or permitted in the belief of the people of the society. It is incorrect therefore to consider alcohol, opium, explosives and the like as beneficial commodities. Beneficial commodities should be viewed in relation to what the society believes in and the ethical values which the society is based upon.

The human needs are not materialistic only. The reference to the needs as being purely materialistic, is wrong, and contradicts the natural reality of human needs. Human beings have moral, spiritual and ethical needs that require satisfaction, which in turn require commodities and services for their satisfaction.

Capitalism seems therefore to concentrate on production of wealth more than distribution of wealth. Distribution of wealth to satisfy the needs has become a secondary issue while the main aim is to increase the country's wealth as a whole. As it seems, the capitalist economy does not attempt to satisfy the needs of all the individuals in the society but rather it is focused on satisfying the needs of the community as a whole by raising the level of production and increasing the national income of the country as a whole. Through the availability of the national income the distribution of income among the members of society occurs, by means of freedom of position and freedom of work. So it is left to the individuals to acquire what they can of the wealth. Whether the individual is not able to satisfy his needs is not of concern to the capitalist economy, as long as the production of goods continues to grow, and the wealth continues to grow.

Capitalism views the economic problem, which faces any society to be the scarcity of commodities and services. It claims that the human needs are steadily increasing, and the products continue to be too scarce to satisfy the growing needs of the people. This view is erroneous and contradicts with reality. This is because the needs which must be met, are the basic needs of the individual as a human (food, shelter, education, health and clothing), and not the luxuries, although they too are sought. The basic needs of humans are limited, and the resources and products (resources and services), are certainly sufficient to satisfy the basic human needs. The basic needs of man as a human do not increase but the luxurious needs usually increase and vary due to urbanization improvement.

Based on the above actual facts, the implementation of capitalism over a period of time should lead to profound poverty and severe dissatisfaction of the needs of many individuals in any society that lives under capitalism.

This major principal of the capitalist economy is inherently wrong, and contradicts reality and does not lead to an improvement in the level of livelihood for all individuals, and does not fulfill the basic needs of every individual (1).

The poverty numbers and rates in the United States for the years 1959-2000 averaged more than 30 million people, with an average of 15% of the population being poor. In the meantime, the gross national product continued to increase drastically over the same period. The GNP grew from \$400 billions to \$10 trillions during the same period. This very large increase in the national product did not contribute to the resolution of poverty.

Globalization is the newer form of global capitalism. It is capitalism across nations. Capital flows between nations without serious constraints. Again, the production of resources and wealth increase and multiply. But the impact of the tremendous growth of wealth does not find its way to satisfy the needs of the people.

Globalization however, proved to be harmful after its implementation for 20 years (2). For economic growth and almost all of the other indicators, a very clear decline in progress has been indicated. The fall in economic growth rates was more pronounced for all groups or countries. The poorest group went from a per capita GDP growth rate of 1.9 percent annually in 1960-80, to decline of 0.5 percent per year (1980-2000). For the middle group which includes mostly poor countries, there was a sharp decline from an annual per capita growth rate of 3.6 percent to just less than 1 percent. The other groups also showed substantial declines in growth rates.

Progress in life expectancy was also reduced. For 4 out of 5 groups of countries with the exception of the highest group (life expectancy 69-75 years) the sharpest slow down was in the second to worst group (life expectancy between 44-53 years).

Progress in reducing infant mortality was slower during the period of globalization (1980-2000) than over the previous two decades. The biggest decline in progress was for the middle to worst performing groups. Progress in reducing child mortality (under 5) was also slower for the middle to worst performing groups of countries.

Progress in education also slowed during the period of globalization. The rate of primary, secondary, and tertiary (post-secondary) school enrollment was slower for most groups of countries.

According to Milanovic and Yitzhaki, 78 percent of the world population is poor, 11 percent belongs to the middle class, and 11 percent is rich (2).

Under the title "Economic health or illness" Dr. Mohammad Malkawi wrote:

"the most important index of economic well being under capitalism is the index that monitors the growth of the nation's health as a whole. DOW Jones, NASDAQ, NIKO, NYSE and other indexes monitor the status of the nation's most powerful companies. A steady increase of these indexes does not record, or reflect the status of the poor in the nation. In fact the overwhelming data shows that poverty and hunger persist despite the steady increase of economic indexes over the years. The daily report of the economic indexes proves one more time that capitalism is inherently concerned about the growth of products, rather than the satisfaction of the needs of the people."

For centuries gold and silver provided a solid base for measuring the exchange value of products and services. Under the pressure of growing economic product growth,

the US specialist economists canceled Briton Woods treaty which establishes a fixed exchange rate of gold, thus making gold one more commodity. The devastating result of this action is the growth of money independent of the growth of products and services. The two major factors that lead to the unlimited growth of money are the interest (usury) and stock investments. Interest allows money to grow without the involvement of products and services. The values of stocks increase or decrease quite often based on circumstances, politics, stability and other factors not directed to the products and services provided by the stock holding companies (1).

Economic growth is seen as good, yet it makes many in the rich world miserable. In the year 2000 George Monbiot wrote in the Guardian, "An increase in wealth is always either preceded or followed by an increase in property rights. Over the past 20 years, wealthy people have laid claim to human genes, public archives, town squares and village greens, playing fields, beaches, even clouds and landing spaces on the moon. Having enhanced their wealth, they retreat to gated communities, hire guards and install CCTV and movement sensors."

Monbiot further added, "Plenty of evidence suggests that as we become richer, we become less content with ourselves. It is incorrect to say that necessity is the mother of invention. In the rich world, invention is the mother of necessity. When the people already possess all the goods and services they need, growth can be stimulated only by discovering new needs...Already, in the rich nations, the beneficiaries of development spend much of their money on escaping from it. It costs a fortune to live in a place that does not assault your eyes and ears with ugliness. To absorb our increasing wealth we must keep building. Our new cars need new roads, our new goods and services must come from new shops and warehouses and offices...Wealth also appear to reduce our capacity to act. Our reliance upon technology supplants our reliance upon ourselves and other people...We know that the world is already rich enough to meet all real human needs, but that this wealth is not trickling down from rich to poor. We know that while there is a desperate need for redistribution, further growth in the rich world is likely to make everyone more miserable. We know that wealth has been romanticized. Yet we are afraid to ask for what we really want. Unless we are brave enough to confront the notion that growth is good, the world will shop until it drops." (2).

Microsoft's Chairman Bill Gates calls for a revision of capitalism. He argues that the economics that drive much of the world should use market forces to address the needs of poor countries. He insists of finding a way to make the aspects of capitalism that serve wealthier people serve poorer people as well. He urged businesses to dedicate their top people to poor issues – an approach he feels is more powerful than traditional corporate donations and volunteered work. Governments should set policies and disburse funds to create financial incentives for businesses to improve the lives of the poor (4).

Today, economic problems come at the head of man's plights. They may be considered the root of life's problems that leave a pervasive impact on man's material interests and social conditions. The result has a direct effect not only on the life of the individual but also on the community and on the level of its material progress and civil development.

The leaders of the world gathered at the World Food Summit in Rome, 1996. They declared, " We consider it intolerable that more than 800 million people throughout the world and particularly in developing countries, do not have enough food to meet their basic nutritional needs...Increased food production, including staple food, must be undertaken..."

In this declaration, the leaders of the world confirm the existence of serious problem in poverty and hunger. In the meantime, they continue to declare that the solution is to increase the resources and products. There is no change in the mechanism of distribution of the resources. The end result will continue to be the same. The production of resources will increase the wealth of the already wealthy, but will not benefit those who need these resources the most (1).

The West has claimed its absolute dependence on the outcome of theories in the fields of material sciences, neglecting however, ideological and philosophical views with regard to the universe, life and man. The West attaches utmost importance to tangible experiments to prove facts and adopt the ensuing results. But contrary to the claimed developments, the example of capitalism in practice proved to be fiascoes. As it seems, the capitalist system so far is neither imparting happiness to man, nor satisfying his basic needs both physical and spiritual. In failing to achieve worldwide security or putting an end to global catastrophes, cultural erosion and moral collapse, continue to increase unabated, while there has been no sign of pinpointing the root causes of anxiety and physiological misery that is sweeping virtually all nations.

Even in the third millennium, the world is once again facing a global crisis which began with the financial crisis that engulfed the world. The "Credit crunch" as it has come to be known brought panic and turmoil in the summer of 2007 to the world's financial markets causing the US housing market bubble to burst.

The collapse of the sub prime housing loan market in the US is a major crisis severely threatening housing lenders. Over 200 US housing lenders have gone bankrupt. Major Banks like Citicorp, the world's biggest bank was forced to write off \$18 billion in dodgy housing loans. Altogether, US and European banks have written off over \$ 120 billion. The sub prime losses in the Us, Britain, Germany and France already surpasses \$120 billion, and is expected to rise to \$ 250 billion or \$ 500 billion. As the credit crunch spreads to other sectors, the total losses could be colossal.

In the US, reliance on debt rose from \$1.50 per dollar of GDP growth during the post-war upswing to \$3 in the 1990s, and to an unprecedented \$4.50 per dollar of GDP growth in 2007.

The bond insurers which play an important role in the bond and securities markets, have been forced to announce huge losses amounting to billions of dollars.

In January 2008, stock exchange speculators around the world woke up to the growing evidence of a US and world recession. Shares plunged between 6-10% on major exchanges, and now reached 15-20% down on October's peak prices.

The massive burden of debt will now be a dead weight on the world economy, dragging the whole world economy into a recession. The overwhelming financial

crisis has severely shaken the confidence in the "magic of the market place". This global economic crisis has already profound effect on the working class and laboring poor around the world. Millions will lose their jobs, their houses, and their modest savings.

It is evident therefore that global capitalism now faces a combined financial crisis and economic slow down. This marks the unsuitability of the current capitalist system to serve the needs of the people and afford them wealth and prosperity; on the contrary, it impoverishes them and threatens their wellbeing.

The financial crisis is a manifestation of the defects of the global financial system. It is evident that the system is incapable of avoiding economic cycles and their build up into bigger ones, prevent rich-poor division, solve global poverty, provide social and economic justice, and address the major problems of the environment

The major factor in the crisis is due to the fact that finance capitalism concerns itself with the making of money out of money and not with the true purpose of the real economy and society. The actual process of money creation takes place primarily in banks. Contrary to popular belief and continual propaganda, banks do not lend their own money or that of the depositors. Instead, lent credit is new money which is created out of nothing, and on repayment, the principal of the loan is cancelled.

When the banking system creates the loan money out of nothing it creates sufficient money for the principal to be repaid but no money is created for the repayment of the interest. Therefore, if the overall money supply is not to shrink, more and more interest-bearing debt must be created. The result however, is more inflation and more people going into debt. That is the fundamental mechanism which lies behind the build-up of individual, town, corporation and national debt.

Conventional economics claims that the system of interest-bearing money serves the needs of the economy by efficiently allocating resources. But this is not true – the banking system money does not allocate its interest-bearing money to new productive capacity and its spreading. Instead, it allocates it to derivatives; to the bidding up of existing asset prices such as house prices; to consumer credit; to putting individuals, companies and societies into debt, to anything but the real, productive economy. Worse, the system favors the short term destruction of natural wealth rather its long term maintenance. Unless the role of interest in the financial system is substantially diminished not only is the environment at risk but so is the stability of the world financial system (5).

Usually, the paying of interest diminishes the capacity of borrowers to repay and diminishes their capacity to consume.

All the factors contributing to the crisis take place against a background of deceitful propaganda and deception about the 'free market'. The truth is that the 'free market' is not free, nor fair and not sufficient and there cannot be true democracy unless all individuals have their own independent productive capacity giving them their own income. Even more, what they call free market is not owned by all people dealing with it, but by small groups of wealthy families monopolizing the market for their own interest.

Chapter 2

2- The Islamic economic system

The economic life of Islam is based upon a comprehensive system of morals and principles. The Islamic economic system is not necessarily concerned with the precise amount of fiscal income and expenditure, imports and exports, and other economic statistics. While such matters are no doubt important, Muslims do not lose sight of the fact that the real purpose of human existence is the worship of Allah.

Islamic economy is a system based on uplifting the deprived masses, a major role for the state in matters such as circulation and equitable distribution of wealth and ensuring participants in the market place are rewarded by being exposed to risk and/or liability.

Islam has condemned all unclean and unlawful means of making money as wicked and sinful. It has also denounced all profits derived from such means as unlawful. On the other hand, Islam has proclaimed great virtues in seeking one's livelihood honestly and in engaging oneself cleanly in trade. As all other aspects of Islamic life, Islamic economy is also governed by Sharia (Islamic religious law). Sharia is the legal framework within which Muslims' life is regulated. It deals with many aspects of day-to-day life including politics, economics, banking, business, contracts, family, sexuality, hygiene and social issues.

The Shariah is based on the Koran, hadith (sayings and deeds of the Prophet), sayings and deeds of the early followers of the Prophet, ijma (consensus of Muslim scholars and jurists on various issues), qiyas (analogical reasoning and textual reasoning), alurf (the custom), al-aql (reason), and centuries of debate, interpretation and precedent, all gathered together and systematized by commentators according to an inductive, casuistic method.

The Prophet said:

"To earn a clean living is also a duty next only to the prescribed duties of faith."

"The cleanest food man can get is that which has been earned by the labor of his own hand. Indeed, the Prophet Dawood (David) used to work with his own hands for the food he ate."

"The trader who plies his trade cleanly and honestly will rise in the Hereafter in the company of the Prophets, saints and martyrs."

Islam has laid great emphasis on honesty and truthfulness in trade and other monetary dealings and described profound virtue and excellence in it. Honest trading is declared to be a means of gaining nearness to Allah. Islam enjoins Muslims to be kind and avoid harshness in their monetary transactions.

The Prophet said:

"Blessings of Allah be on him who is mild and gentle in his business transactions and in the realization of his dues."

Earning one's living through decent labor is not only a duty in Islam, but also a great virtue as well. Dependence of any able person on somebody else for a livelihood is a religious sin. Man is obliged to exert his utmost efforts in working and utilizing nature's resources to his interests.

Allah the Exalted says:

It is He who made the earth submissive to you; therefore walk in its tracts, and eat of His provision; to Him is the Uprising (Al-Mulk, 15).

Business transactions enjoy a great deal of attention from Islam. Honest trade is permitted and blessed by Allah. This may be carried out through individuals, companies, agencies, and the like. But all business deals should be concluded with fairness and honesty. Cheating, binding defects of merchandise from the dealers, exploiting the needs of customers, monopoly of stocks to force one's own prices are all sinful acts and punishable by the Islamic Law.

The meticulous care with which Islam has distinguished between right and wrong in respect of the means of earning wealth is not to be found in any other legal or social system. It condemns as illegal all those means of livelihood which injure, morally or materially, the interests of another individual or of society as a whole. Islamic law categorically rejects as illegal the manufacture and sale of alcoholic beverages and other intoxicants, adultery, pork, pornographic material, professional dancing, gambling, transaction of a speculative or fraudulent nature, transactions in which the gain of one party is absolutely guaranteed while that of the other part is left uncertain and doubtful, and price manipulation by withholding the sale of the necessities of life.

Islam forbids all these by law, and allows freedom of earning wealth only by those means through which a person renders some real and useful service to the community. If one has to make a decent living, it has to be made through honest ways and hard endeavor. Anyone that is bred with unlawful provision, his flesh will be according to the Prophet, a burning fuel to the Hell-Fire on the Day of Judgment.

The economic bases of the Islamic economy as derived from the Koran, the Sunnah of the Prophet and the Sharia (Islamic law).

1- The first and most important basic principle is that everything has to start from the belief in Allah as the Creator, Lord, and Sovereign of the universe. This implies willingness to submit to Allah's will, to accept His guidance and to have complete surrender and servitude to Him. This means that Muslims should not imitate or emulate any other system if it differs from their particular principles.

2- The second basic principle is that Islam as a religion is a divine revelation guiding Muslims in all walks of life: moral, social, ethical, economical, political, etc. Therefore, it is not proper that a person accepts Allah's teaching in one matter and refuses it in another. Everything has to be within the basic guidance.

...And We have revealed to you in stages this Book, a clarification of all things, a guidance, a mercy, and glad tidings... (An-Nahl, 89).

3- The third principle is that Allah created all resources in the world. Allah states in the Koran that all the resources in the world are created by Him, and made usable to mankind by the virtue of the laws that He injected into the resources:

It is He Who created for you all that exists on earth (Al-Baqarahh, 29).

And We sent down iron, in which is great might, as well as many benefits for mankind (Al-Hadid, 25).

Let man consider his food. How We pour water in showers. Then split the earth in fragments. And cause the grains to grow therein. And grapes and fresh vegetation. And olives and dates, and enclosed gardens, dense with lofty trees. And fruits and grazes. Provision for you and your cattle (Abasa 24-32).

Allah demonstrated in these verses and others that He created property for people to utilize. Allah did not interfere with the production of wealth; on the contrary, He left to the people the matter of extracting the property and improving man's effort.

It was narrated that the Prophet said in the issue of manual pollination of date trees:

"You are more aware of the routine issues of your daily life."

It is also narrated that the Prophet sent two of the Muslims to Jurash of Yemen to learn weapons manufacturing.

These examples indicate that the Sharia has left the matter of production of wealth to the people, to be produced according to their experience and knowledge. It is evident therefore that Islam focuses on the principles of the economic system and not economic science (1).

4- The fourth principle is that the real ownership belongs to Allah. Man is in fact a trustee that has been given the authority to manage Allah's money and property with equity and justice according to the moral and ethical values mentioned in the Koran, the Sunna, and the Sharia. Islam provides therefore, an opportunity in material progress, thereby combining moral, social, and material progress, all interlinked in harmony.

5- The fifth principle is that Allah in order to enable man to fulfill the responsibility of trusteeship, has made everything in this universe subservient to him.

Allah is He who has subjected to you the sea, that the ships may run on it at His commandment, and that you may seek His bounty; haply so you will be thankful. And He has subjected to you what is in the heavens and what is in the earth, all together, from Him. Surely in that are signs for a people who reflect (Al-Jâthiyah 12, 13).

This does not mean, however, that man has been given free reign to use and abuse the resources Allah has created for the good and benefit of his servants. The resources must be used wisely and within the boundaries Allah has indicated in the Koran.

Allah says:

It is He who produces gardens trellised and untrellised, palm-trees, and crops diverse in produce, olives, pomegranates, similar (in kind) and different (in taste). Eat of their fruits when they ripen, and pay the due thereof on the day of its harvest; and be not prodigal; Allah loves not the prodigal (Al-An'âm, 141).

6- The sixth principle is the principle of accountability in the Hereafter. Every person will be accountable to Allah in all his earthly deeds. Allah has given man trusteeship and resources, and in the Hereafter he will be questioned as to how he used the resources and how he economically behaved whilst enjoying his earthly life.

Allah says:

**Surely he (man) is passionate in his love for good things.
Knows he not that when that which is in the tombs is overthrown.
And that which is in the breasts is brought out.
Surely on that Day their Lord shall be aware of them (Al-Âdiyât 8-11).**

7- The seventh principle is that the variation of wealth among people does not give a person either inferiority or superiority in the sight of Allah. Out of His Infinite Justice and Wisdom, Allah increases His provision to whom He pleases and straitens it in regards to others.

Allah outspreads and straitens His provision unto whomsoever He will. They rejoice in the present life; and this present life, beside the world to come, is naught but passing enjoyment (Ar-ra'd, 26).

Affluence like poverty is seen by Allah as a trial. Allah wants to know what people will do with their wealth, are they going to misuse it and forget that it is a trustee from Allah, or they will use it constructively in ways legislated in the religion?

Allah says:

Your wealth and your children are only a trial; and with Allah is a mighty wage (Al-Taghâbun, 15).

Allah is not concerned with the amount of wealth a person may have amassed, but His measure of honor is the piety of the hearts.

Allah says:

O mankind, We have created you male and female, and appointed you races and tribes, that you may know one another. Surely the noblest among you in the sight of Allah is the most god-fearing of you. Allah is All-Knowing, All-Aware (Al-Hujurât, 13)

The Prophet also said:

"Indeed Allah is not concerned with your appearances nor your wealth, but rather your hearts and deeds." (Saheeh Muslim).

8- The eighth principle is that trading must be in lawful things .Trading in prostitution, liquor, drugs, slavery, pork or any other commodity that may detrimentally affect man's life is totally forbidden.

It is concluded from these principles that the Islamic economic system is radically different from all other economic systems due to the difference in the values upon which it is based. In a capitalist society, one may see certain rules of economics which take precedence over moral and ethical values. The same may be seen in socialist and communist economic systems. The Islamic economic system however, with its ethical values derived from the Koran and the Sunna of the Prophet, establishes the balance between lawful personal benefit and the benefit of the society as a whole. It guarantees mundane profits and spiritual gains, all which ensure in the end the pleasure of Allah, the Lord of the worlds (6).

The Prophet said:

"Whom who ends his day with security at home, with healthy body, and with food at home has acquired his needs in this life."

The Prophet also said:

"Allah breaks covenant with any group of people living in close vicinity, whereby one of them goes to bed while hungry."

The most important feature of Islamic economy is social justice. The economic policy of Islam aims at securing all the basic needs for every individual living in an Islamic society. This is achieved by obliging every capable person to work, so as to achieve the basic need for himself and his dependants. Islam obliges the sons to support their parents if they are not able to work, or obliges the State treasury to do so, if there is nobody to support them. Islam requires that the individual secures for himself and his dependants the basic needs i.e. adequate foodstuffs, clothing, medication and housing. Islam then encourages the individual to secure the luxuries of life as much as he can.

In order to satisfy all the basic needs of the individual, and to achieve the satisfaction of the luxuries, the economic commodity should be available to people, and it will not be available to them unless they strive to earn it. Therefore, Islam urges people to earn, seek the provision and strive. In Islam, striving to earn the provision is compulsory upon all Muslims.

Allah said:

"So walk in the paths of the earth and eat of His sustenance which He provides." (Al-Mulk, 15).

The Prophet shook the hand of his companion, Sa'ad ibn Muadh and found his hands to be rough. When the Prophet asked about it, Sa'ad said, "I dig with the shovel to maintain my family." The Prophet kissed Sa'ad's hands and said, "**(They are) two hands which Allah loves.**"

The Prophet said:

"Nobody would ever eat food that is better than to eat of his own hand's work."

As the Koranic verses and sayings of the Prophet encourage striving to seek provision, and working to earn property, the verses encourage the enjoyment of the property and the eating of the good things:

"Say: who has forbidden the beautiful gifts of Allah, which He has provided for His servants, and the things clean and pure, (that He has provided)?" (Al-A'raf, 32).

"And let not those who are niggardly, who withhold the gifts which Allah has given them from His Grace, think that it is good for them. Rather it is worse for them. That which they hoard will be their collar on the Day of Resurrection. And to Allah belongs the heritage of the heavens and the earth, and Allah is well acquainted with all that you do." (Al-Imran, 180).

"O you who believe! Spend of the good things which you have earned, and of that which We bring forth from the earth for you." (Al-Baqarah, 267).

The aim of owning property in Islam is to satisfy man's need and not for boasting. The managing of property in Islam must be according to Allah's orders; Muslims must seek the Hereafter through the lawful management of what they earn and also not to forget their share of the worldly life.

Allah says:

"But seek the abode of the Hereafter in that which Allah has given you, and do not neglect your portion of worldly life, and be kind as Allah has been kind to you, and seek not corruption in the earth." (Al-Qasas, 77).

As Professor M.N. Siddiqi (7) put it, the following is the moral foundations of finance in Islam:

Islam looks at wealth as life sustaining, to be used efficiently. Allah says:

And give not unto the foolish your wealth which Allah has made a means of support for you (An-Nisâ, 5).

As stated above, private ownership is affirmed but viewed as a trust:

Believe in Allah and His Messenger, and spend of that whereof He has made you trustees (Al-Hadîd, 7).

Islam encourages enterprise, effort to create wealth, which has been characterized as Allah's bounty:

And when prayer is ended, then disperse in the land and seek Allah's bounty (Al-Jumu'ah, 10).

Muslims are obliged to fulfill contracts and keep their promises:

O believers, fulfill your bonds (Al-Mâidah, 1).

...And be true to every promise, for, verily, (on Judgment Day) you will be called to account for every promise you made (Al-Isrâ', 34).

All exchange should be with willing consent of the parties concerned:

O believers, consume not your goods between you in vanity, except there be trading, by your agreeing together (An-Nisâ, 29).

Use of wealth and exercise of freedom of enterprise is constrained by the obligation not to harm others. The Prophet said:

"No injury, and no inflicting injury."

These has to be seen in the perspective of the positive obligation to care for others and share with them wealth by paying Zakat or poor tax. But that is not all; the important thing is the spirit of cooperative, helpful behavior as mandated by the Islamic view on life being a test:

Who has created life and death that He may try you, which of you is best in conduct (Al-Mulk, 2).

These clear texts provide a sound basis for a positive attitude towards wealth creation and economic activity. Clear and secure individual ownership rights, one's right to the fruits of one's efforts and contracts enforceable through a social authority strengthen that attitude and provide a wide arena for it (7).

Having put production and exchange of wealth on a firm basis, Islam proceeds to define a frame work for these activities so that justice and fairness is ensured for all concerned. The environment should be prepared for the growth of fair economy that would match the divine instructions directed to the use of wealth in an Islamic community. This is achieved by prohibiting certain economic practices viewed by Islam as unlawful due to their evil and bad consequences on the growth of a just and equitable Islamic economy.

In order to ensure equitable distribution among the individuals of the Islamic society the following economic practices are prohibited:

1- Reba: i.e. usury or interest on lawns. The Koran and the Sharia look upon consumption of usury as serious offense. Islamic law does not distinguish between high rates of interest characterized as usury, and lower rates characterized as interest.

Any excess over and above the sum lent is disallowed. Prohibition of interest on loans is clearly indicated in the Koran:

Those who devour usury will not stand (on the Day of Resurrection) except like the standing of a person beaten by Satan leading him to insanity; that is because they say, 'trading is like usury.' Allah has permitted trading, and forbidden usury. Whosoever receives an admonition from his Lord and stops eating usury shall not be punished for the past, and his affair is committed to Allah; but whosoever reverts – those are the inhabitants of the Fire, therein dwelling for ever. Allah blots out usury, but freewill offerings He augments with interest. Allah loves not the disbelievers, sinners (Al-Baqarahh 275, 276).

Ye who believe! Fear Allah, and give up what remains of your demand for usury, if ye are indeed believers (Al-Baqarahh, 278).

The Prophet said:

"Allah damned the one who practices usury and the one who pays him as well as its two witnesses and the one who writes it down. They are equally guilty of committing that sin."

2- Maysir: i.e. gambling bets and wager. Gambling is not considered by Islam a real economic activity that would contribute to the progress of sound economy. Gambling corrupts morals, making people sluggish in waiting for providence by whimsical means and giving up economic activities essential for making true earnings. Gambling enslaves the gambler who becomes a mute slave in the hands of gambling and seldom succeeds in abandoning it. Gambling creates a great economic imbalance; the fortunate becomes richer, whilst the less fortunate becomes poorer and his loss is complete. The risk resulting from gambling is deliberately created or invited, an activity frequently causing economic imbalance (7).

3- Ghabn: i.e. fraud and deception.

4- Ikrah: i.e. coercion, e.g. imposing a contract, or a condition therein, on an unwilling party.

5- Bay'al-mudtarr: i.e. exploitation of need, e.g. by charging an exorbitantly high price.

6- Ihtikar: i.e. withholding supplies of essential goods and services with a view to raising prices.

7-Najsh: i.e. raising prices by manipulating false bids

8- Gharar: i.e. hazard or uncertainty surrounding a commodity, its price, and time of payment, time of delivery, quantity etc., that would impair the validity of a contract. For example, it is forbidden to sell fish in rivers or the ocean since we do not exactly know when or whether such fish will be caught. The concept of Gharar and the idea behind its prohibition can be extended to various contracts, e.g. property that is legally subject to claims from other parties should not be sold until the legal dispute and

claims are settled since the purchase of such a property can cause the purchaser loss if valid claims and entitlements lead to the loss of ownership. The Prophet prohibited Gharar-mode of sale to protect people's wealth from being destroyed and to prevent disputes between people.

9- Jahl mufdi ila al-niza', i.e. lack of information about a commodity, its quantity, price, etc., as may lead to dispute.

10- Procrastination in payment is forbidden in Islam. The Prophet said:

"Procrastination of a wealthy person in the discharge of debt is oppression..."

Procrastination in payment is detested when one is financially capacitated to discharge the debt, because this means holding back capital which the creditor requires for his needs. Such deferment prevents the creditor from possible profitable investment. Debtors have to be clean-hearted and grant people their dues.

Chapter 3

Instruments of the Islamic economy

Based on the principles of the Koran and the Sunna of the Prophet, the Islamic society witnessed vigorous economic activity since the day the Prophet migrated to Medina. The first four to six centuries recorded continued expansion and increasing prosperity. Monetization came early and the ban on unequal exchange of similar fungibles seems to have expedited the process. Muslims started with gold dinars from the Byzantine and silver dirhams from Persia, but very soon they took to minting their own coins. The state had the monopoly of coinage and any tampering with their weight or purity was severely punished.

It is not surprising that trade and commerce over the vast expanse of the world of Islam including northern parts of Africa, Spain in Europe and a large part of Asia, soon produced certain elementary financial instruments (7).

Chief among these instruments are:

1. Suftaja (bill of exchange) and sakk (check).
2. Financial contracts. Muslims used customary contracts known in the Arabian Peninsula and other parts of the land of Islam.

The following is the types of such Islamic financial contracts:

1. Mudarabah: i.e. profit-sharing. Supplier of money capital contracts with a working partner on the basis of sharing the resulting profits. Losses if any, are considered loss of capital and borne by the owner of capital. The working partner, in that case, goes unrewarded for his effort.
2. Musharakah: i.e. partnership. In partnership two or more parties supply capital as well as work/effort. They share the resulting profits according to agreed proportions, but losses are to be borne in proportion to respective capitals.
3. Wakala: i.e. agency. Business is managed by an agent appointed by the principal owner. Agent's compensation may take different forms.
4. Ju'ala: i.e. reward which is given on successful completion of a specified job. There is no compensation in case of failure.
5. Ijara: i.e. leasing.
6. Salam: i.e. payment now for agricultural products to be delivered at a specified time in future, with the price being agreed now.
7. Istisna': i.e. Salam applied to manufactured goods, with the possibility of payment in installments as the goods are delivered.

8. Arboon: i.e. depositing a small amount of price in a deal to be concluded in future. It binds the seller to wait but allows the buyer to back out of the deal, with the seller keeping the deposit.

9. Murabaha: i.e. a sale agreement under which the seller purchases goods desired by a buyer and sells it to him/her at an agreed marked up price, payment being deferred. It is a modern adaptation of an earlier contract in which deferment was not necessarily involved. The higher price paid would leave a margin for the seller in order to reward him/her for expertise in bargaining, better knowledge of market conditions, etc. It may be added that Islamic law allows a seller to sell on credit on a price higher than he/she was charging for payment on the spot. In fact it is regarded to be an aspect of freedom of enterprise, the seller's freedom to ask for a price and he/she thinks to cover his/her costs and leave a decent profit.

10 - Kard hasan: i.e. good loan or beneficial loan, that is interest free, addressed as a charity to the poor and needy, its role in business enterprise has been marginal, but it contributes to the social equity of the society (7). Allah declares in the Koran that whoever gives a loan (no interest) to another person is indeed giving a loan to Allah. In return, Allah multiplies the reward for the loan giver. Qard hasan is a manifestation of not being niggardly. It expresses Muslims' gratitude to Allah for the gifts that He bestowed on them.

11- Waqf: the word Waqf is used in Islam in the meaning of holding certain property and preserving it for the confined benefit of certain philanthropy and prohibiting any use or disposition of it outside that specific objective. Waqf applies to non perishable property whose benefit can be extracted without consuming the property itself. Therefore Waqf widely relates to land and buildings. However, there are Waqf of books, agricultural machinery, cattle, shares and stocks. Philanthropic Waqf aims at supporting the poor segment of the society and all activities which are of interest to people at large such as libraries, scientific research, education, health services, care of animals and environment, lending to small businessmen, parks, roads, bridges, dams, etc.

The founder of the Waqf must have full right of disposal over property. Thus he must have unrestricted ownership of the Waqf and must be in full possession of his faculties, be of age and a free man.

Philanthropic Waqf began by the Prophet Muhammad. A man called Mukhairiq made his will that his seven orchards in Medina be given after his death to the Prophet. After his death the Prophet took hold of the orchards and made them a charitable Waqf for the benefit of the poor and needy. This practice was followed by the companions of the Prophet and his second successor Umar, who asked the Prophet what to do with a palm orchard he got in the northern Arabian Peninsula city of Khaibar and the Prophet said: **"If you like, you may hold the property as Wakf and gives its fruits as charity."**

In addition to the above mentioned tools, certain other issues are included to support the role of the Islamic financial instruments:

- 1- Zakat al-mal (wealth tax) as a category of the Islamic social scheme is to be mentioned. Islam has waged a war on poverty by all means. It is the poverty of the individual that Islam is concerned with, in addition to the poverty of the nation as a whole. Islam has instituted the charity, called Zakat in a manner that eliminates the poverty altogether. Zakat in Islam is a means of worship. It is one of the pillars of Islam as much as the prayer is. Zakat is paid to the poor to bring them up to the general standard of the society.
- 2- Baitul-Maal (public treasury) has been incepted in Islam for the accumulation of State income and for the just distribution of such resources into diverse social and economic avenues. The state income comprises of Zakat, voluntary contributions, taxes and investment income. The public treasury aids various categories of people who deserve assistance. Those in debt are also aided to discharge specific debts, which they are incapacitated from discharging. Debts of the deserving deceased could also be discharged from the public treasury.

Allah says in the Koran:

If the debtor is in a difficulty, grant him time till it is easy for him to repay. But if ye remit it by way of charity, that is best for you if ye only knew (Al-Baqarah, 280).

- 3- Debts. As for the borrowers, the Prophet used to urge them to do their best to pay back their debts quickly lest they die in a state of indebtedness.

The Prophet said:

"If a person is killed in the path of Allah, all his sins will be forgiven (by virtue of his martyrdom) but if he owes anyone anything, his martyrdom will not secure his release from it."

"By the Lord in whose power rests the life of Muhammad, if a person falls as a martyr in the path of Allah and returns to life, and is killed again in the path of Allah and returns to life only to be killed once more in the cause of Allah, and there is still a debt outstanding against him, he will not be able to enter paradise (until it is settled)."

- 4- The debt of the deceased should be repaid otherwise the deceased will not enter paradise. It is narrated that the Prophet attended the funeral of one of his companions. The Prophet inquired if one of the deceased relatives was present. A person stood up saying, "I, O Messenger of Allah." The Prophet said, " **The deceased of your family is prevented from entry into Jannah (heaven) due to his debt.**" The relative of the deceased then said, "I then saw that the Prophet repaid the debt of the deceased until none remained to claim any further amount from him." The Prophet preferred the benefit of the deceased by having his debt settled. Muslims are therefore encouraged to fulfill the debts of the deceased so that the latter are freed of such obligation in the Hereafter. This shows the importance that Islam has given to debt fulfillment.

5- Property: The Koran states that Allah is the sole owner of all things in the heavens and the earth

Knowest thou not that to Allah belongs the kingdom of the heavens and the earth, and that you have none, apart from Allah, neither protector nor helper (Al-Baqarah, 105).

Islam defined three types of property; public property, state property and private property.

Public property: public property refers to natural resources (forests, pastures, uncultivated land, water, mines, oceanic resources etc.) over which all humans have equal right. Such resources are considered the common property of the community and are placed under the guardianship and control of the Islamic state. It can be utilized, as long as it does not undermine the right of other citizens over it.

State property: state property includes certain natural resources, as well as other property that cannot immediately be privatized. State property can be movable; can be acquired through conquest, or peaceful means. Unclaimed and unoccupied properties, including uncultivated land can be considered state property. During the life of the Prophet, one fifth of military equipment captured from the enemy in the battlefield was considered state property.

During his reign, Omar considered conquered land to be state property instead of private property as was usual practice. The reason for this was that privatizing this property would concentrate resources in the hands of a few, and prevent this property from being used for the general good of the community. The property remained under the occupation of the cultivators, but the taxes collected on it went to the state treasury.

Private property: Islam recognizes and upholds the individual's right to private ownership. The Koran extensively discusses taxation, inheritance, prohibition against stealing, legality of ownership, recommendation to give charity and other topics related to private property. Islam also guarantees the protection of private property by imposing stringent punishments on thieves. The Prophet said that he who dies defending his property was like a martyr.

Islamic economists have classified the acquisition of private property into three categories: involuntary, contractual and non-contractual. Involuntary means are inheritance, bequests, and gifts. Non-contractual is acquisition that involves the collection and exploitation of natural resources that have not previously been claimed as private property. Contractual acquisition includes activities such as trading, buying, renting, hiring labor etc.

A tradition attributed to the Prophet that in cases where the right to private ownership causes harm to others, then the state can limit the amount an individual is allowed to own (8).

6- Market: Islam considers markets as the basic co-coordinating mechanism of economic system. Islamic teaching holds that the market, through perfect competition

allows consumers to obtain desired goods, producers to sell their goods at a mutually acceptable price.

The three necessary conditions for an operational market are mentioned in Islamic primary sources:

- a- Freedom of exchange: the Koran calls on believers to engage in trade, and rejects the contention that trade is forbidden.

O believers, consume not your goods between you in vanity, except there be trading, by your agreeing together... (An-Nisâ, 29).

- b- Private ownership as indicated above.
- c- Security of contract: The Koran calls for the fulfillment and observation of contracts.

The longest verse of the Koran deals with commercial contracts involving immediate and future payments.

O believers when you contract a debt for a stated term, write it down, and let a writer write it down between you justly, and let not any writer refuse to write it down, as Allah has taught him; so let him write, and let the debtor dictate, and let him fear Allah his Lord and not diminish aught of it. And if the debtor be a fool, or weak or unable to dictate himself, then let his guardian dictate justly. And call in to witness two witnesses, men; or if the two be not men, then one man and two women, such witnesses as you approve of, that if one of the two women errs the other will remind her; and let the witnesses not refuse, whenever they are summoned.

And be not loath to write it down, whether it be small or great, with its term; that is more equitable in Allah's sight, more upright for testimony, and likelier that you will not be in doubt. Unless it be merchandise present that you give and take between you; then it shall be no fault in you if you do not write it down. And take witnesses when you are trafficking one with another.

And let not either writer or witness be pressed; or if you do, that is ungodliness in you. And fear Allah; Allah teaches you, and Allah has knowledge of everything (Al-Baqarah, 282).

And if you are upon a journey, and you do not find a writer, then a pledge in hand. But if one of you trusts another, let him who is trusted deliver his trust, and let him fear Allah his Lord. And do not conceal the testimony; whoso conceals it, his heart is sinful; and Allah has knowledge of the things you do (Al-Baqarah, 283).

Warning to fraudulent traders is implicitly mentioned in the Koran.

Woe to those who give less in measure and weight. Those who, when they have to receive by measure from men, demand full measure.

And when they have to give by measure or weight to (other) men, give less than due.

Do they not think that they shall be raised up unto a mighty Day.

A Day when mankind shall stand before the Lord of all-Being (Al-Mutaffifeen 1-5).

Fill up the measure, and be not cheaters, and weigh with the straight balance, and diminish not the goods of the people, and do not mischief in the earth, working corruption (Al-Shu'arā' 181-183).

All dealings in the market must be honest and straight. Justice is the central virtue, and applying justice in economic deals keeps the human world balanced. The Koran urged Muslims to act justly to each other and observe due balance in trading.

And heaven He raised it up, and set the Balance. Transgress not in the Balance, and weigh with justice, and skimp not in Balance (Al-Rahman, 7-9).

Islam recognizes the role of the market in the efficient allocation of resources, but does not find competition to be sufficient to safeguard social interest. It tries to promote human brotherhood, socio-economic justice and the well-being of all through an integrated role of moral values, market mechanism, families, society, and good governance.

The market is not the only institution where people interact in human society. They also interact in the family, the society and the government, and their interaction in all these institutions is closely interrelated. There is no doubt that the serving of self-interest does help raise efficiency in the market place. However, if self-interest is overemphasized, and there are no moral restraints on individual behavior, other institutions may not work effectively; families may disintegrate, the society may be uncaring, and the government may be corrupted, partisan and self-centered.

The Islamic economy places great emphasis on individual and social reform through moral uplift. Before entering the market place and being exposed to the price filter, consumers are expected to pass their claims through the moral filter. This will help filter out conspicuous consumption and all wasteful and unnecessary claims on resources. The price mechanism can therefore take over and reduce the claims on resources even further to lead to the market equilibrium. The two filters can together make it possible to have optimum economy in the use of resources, to reduce the concentration of wealth in a few hands, and to raise savings, which are needed to promote greater investment and employment.

Islam promotes market free interferences such as price fixing and hoarding. Government intervention, however, is tolerated under certain circumstances. Islam prohibits the fixation of price by a handful of buyers or sellers who have become dominant in the market. At the time of the Prophet, a small group of merchants used to meet with agricultural producers outside the city of Medina and bought the entire crop, thereby gaining monopoly over the market. The produce was later sold at a higher price within the city of Medina. The Prophet condemned this practice since it caused injury both to the producers who in the absence of numerous customers were

forced to sell goods at a lower price and the inhabitants of Medina who had to buy the products at higher price.

It is therefore evident that the Islamic market is characterized by free information. Producers and consumers should be denied information on demand and supply conditions. Producers are expected to inform consumers of the quality and quantity of goods they claim to sell. Islamic scholars hold that if an inexperienced buyer is swayed by the seller, the consumer may nullify the transaction upon realizing the seller's unfair treatment. The Koran forbids discriminatory means of transaction as stated by the verses above (8).

The ethical fundamental principles of the Islamic economy are adequately served by the financial instruments mentioned above. The institution of profit-sharing (Mudarabah) or equity participation (Musharakah) at all levels of the Islamic economy is the principal alternative for replacing interest-bearing transactions. In other words, the Koranic alternative to Reba is trade and commerce. The essence of trade and commerce is profit creation that implicates risk-taking (ghorm) and value-addition (kasb). Doing so promotes fairness and equitable transactions ('adl) and thus putting ethics and morality (akhlak) into the limelight of corporate business today. The institution of Mudarabah and Musharakah are important instruments for making the elimination of Reba (usury) effective. The Koran has placed the highest importance along with prayers, on the duty of paying wealth tax (Zakat) by the wealthy for the rehabilitation of the needy. Zakat revenues are to be collected and disbursed in an organized way. In early era of Islam this method of managing Zakat funds was the responsibility of the public treasury. Zakat along with elimination of Reba and its replacement by Mudarabah and Musharakah, constitutes a form of enhanced spending in the economy. The absence of interest-bearing on personal loans along with the gift of Zakat generates a form of grants economy, with their impetus on investment and spending through the attributes of human solidarity and good will.

In other words, Islamic finance ensures closer linkage between real economy and finance, the former dictating and the latter following. The linkage is obvious in sharing based modes of investment and financial services. When two parties, the financier and the entrepreneur, agree that an opportunity for creating additional value exists, they come together to realize the gain and share it. Since economic activities are by definition value creating activities, sharing as a basis of finance is inconceivable without economic activity.

This linkage between real economic activity directed towards creation of additional wealth and financial transactions continues in case of non-sharing Islamic modes of finance such as Murabaha (cost-plus), Salam and Istisna (prepaid orders) and Ijara (leasing). These deals, which are being used by contemporary Islamic banks to secure predetermined returns on their investments, are possible only when some real economic activity is involved. There have to be some goods and services to be objects of Murabaha, Salam, Istisna and Ijara. The demand and supply of these goods and services whose exchange is financed through these kinds of contracts ensures that financial activity is the servant not the master of real economic activity.

Prohibition of interests has closed the door on exchange of more money for less money, even when a period of time intervenes. Interest free Islamic modes of finance can replace the conventional interest based finance with certain added advantages, by

synchronizing entrepreneurial payment obligations and accrual of revenues; sharing based modes of finance remove a major source of instability from freely functioning markets. Also by linking financial intermediaries returns to the actual revenue of the fund users, allocation of investable funds is directed to projects expected to produce more value than their alternatives (9).

The Koran is emphatic on the elimination of economic waste through ostentatious consumption and wasteful production (Israf). Elimination of Israf is seen to logically link up with the efficiency of Mudarabah, which then results in an impetus to eliminate Reba. Reba itself is considered as a form of Israf in the Islamic sense. An effective reduction of waste followed by its consequential relationship with Mudarabah, would mobilize capital into productive investments. This will have an enhancing effect on Zakat to combat poverty and generate more distribution.

The financial instruments, abolition of Reba, institutions of Mudarabah/Musharakah, the institution of wealth tax, Zakat, and the elimination of waste (Israf), are not the only instruments operating in the market; other financial instruments are also operating e.g. Murabaha, unit trust, Ijara (rental), leasing (Ba'y Muajal), interest-free loans (Qard Hassan), endowments (Waqf), redistribution of wealth through the laws of Islamic inheritance, state intervention for the benefit of the individual and the society through its emphasis on prohibition of Israf, fighting poverty and providing subsistence for every individual, etc. (10).

The state in its intervention in the market should not acquire the character of a monolithic or despotic state resorting to a high degree of regimentation. It should not consider that because it has authority, it can do anything it likes. It should be welfare-oriented, moderate in its spending, respect the property rights of the people, and avoid onerous taxation. This is what Islamic scholars refer to as "good governance."

Chapter 4

Resurgence of the Islamic Economic System in Modern Time

The current world financial crisis should have taken lessons from the Islamic economic system. The global financial crisis highlighted the Islamic economy as the most suitable as it contains the provisions for protecting both wealth and financial interests of the people. The Islamic financial institutions are now promoting Islamic economy and marketing it in various parts of the world. The purpose is to crystallize the idea of Islamic economy as an effective tool in solving the frequent failure of the global capitalist economic system.

In recent times, Islamic economics has experienced vigorous pursuit among Islamic and non-Islamic thinkers alike. The need for Islamic economics arose as more and more Islamic nations got independence from colonial power after World War II. During colonization the occupiers managed the economies of the Muslim countries according to their own western financial systems. After independence, the national conscience grew, and the urge to manage their affairs in accordance with their own values and traditions emerged in the Islamic countries.

One of the difficulties that slowed down the application of Islamic economy was that, the outlets for mobilizing the resources of the Islamic communities were not Islamic in character.

In the face of the growing Islamic commercial and financial developments that have taken place during the last decades, Islamic economists conducted immense research in the fields of Islamic finance; money and banking; financing development and resource mobilization; theory and application of Sharia in developing secondary capital market instruments; macroeconomic models of Islamic economic systems; monetary and investment relationships; Islamic economic history; and international Islamic economic co-operation. Social welfare, unemployment, public debt and globalization have been re-examined from the perspective of Islamic norms and values.

As a result of such studies, the Islamic financial transactions have made their presence felt today in most all financial institutions including banks, unit trusts, insurance, discount houses, fund management, factoring, pawn broking and project financing.

The Islamic Banking and finance in modern time can be seen in several Muslim countries. The Dubai Islamic Bank was established in 1975 under a special law allowing it to engage in business enterprises while accepting deposits into checking accounts. In 1985, 27 more banks were established in the same manner in the Gulf countries, Egypt, and Sudan. Many more were to follow across the Muslim world (Iran; Pakistan; Turkey; Malaysia; Indonesia etc.) and over 50 banks were established, some of them are located at money centers like London. Moreover, conventional banks followed suit and established Islamic branches dealing exclusively in Islamic products. Citi-Islamic in Bahrain and Grindlays in Karachi were followed by the National Commercial Bank in Saudi Arabia establishing over 50 Islamic branches by 1990s.

Islamic investment and insurance companies also appeared in the late 1970s and grew in number. Later in the 1990s a number of Islamic mutual funds appeared, many of them being managed by reputed western firms.

By the year 2000, there were 200 Islamic financial institutions with over \$8 billions in capital, over \$100 billions in deposits, managing assets worth more than \$160 billions. About 40% of these are in the Persian Gulf and the Middle East, another 40% in south and Southeast Asia, the remaining is equally divided between Africa on the one hand and Europe and the Americas on the other hand. Two thirds of these institutions are very small, with assets less than 100 million US dollars.

The Organization of Islamic Conference (OIC) took several steps culminating in the establishment of the Islamic Development Bank (IDB) which would serve the entire Muslim nations. Share capital initially fixed at US dollars, two billion was supplied by member countries. The purpose is to foster economic development and social progress of member countries and Muslim communities in accordance with the principles of Sharia. In compliance, the IDB does not deal with interest.

By the year 2000 the Islamic Development Bank (IDB) had financed inter-Islamic trade to the tune of over 8 billion US dollars mostly using the mark up technique. It also gives loans, taking only service charges according to actual administrative expenditures. But it does try to promote sharing based modes of financing. It is also managing an investment portfolio in which individual Islamic banks place their surplus liquidity.

For further details see [The Foundation of Islamic Finance-Finance in Islam: <http://financeinislam.com/article>].

With more than \$200 billion Islamic funds available in global finance today, it is logical that the business of Islamic banking, insurance and fund management is fast expanding and encroaching into non- traditional financing.

In June 2005 Dow Jones Indexes, New York, and RHB securities, Kuala Lumpur, teamed up to launch a new "Islamic Malaysia Index" a collection of 45 stocks representing Malaysian companies that comply with a variety of Sharia-based criteria.

Today Islamic banking institutions take several forms, including Islamic commercial banks, investment and holding companies, Takaful (insurance) companies as well as development banks. The size of these institutions varies greatly, from small-time operators to others such as the Al-Rajhi Banking and Investment Corporation of Saudi Arabia that has assets totaling almost 8 billion.

Today there are many financial institutions, even in the Western world, offering financial services and products in accordance with the rules of the Islamic finance. Legal changes introduced by Chancellor Gordon Brown in 2003, have enabled British banks and building societies to offer Muslim mortgages for house purchase.

In 2004 the first British bank complying with the principles of Sharia was launched, the Islamic Bank of Britain. The bank offers products and services to its UK customers that utilize the Islamic financial principles; such as Mudaraba, Murabaha, Musharaka and Qard. In the years to come, as Islamic banking expands into new areas, there would certainly be an increased effort in broadening its principles and scope (10).

There are already five wholly Islamic banks in London, and the first Islamic bank will open in France in 2009.

The experience of Islamic banking in the United Kingdom has been extremely positive. Islamic bank of Britain has been operating as a retail bank for over four years, and has attracted over 40,000 customers. HSBC Amanah, the Islamic finance subsidiary of HSBC, has been operating for ten years in London, focusing mainly on institutional clients and business finance.

Alburaq, the Islamic finance subsidiary of the Arab Banking Corporation, has become the market leader for Sharia compliant home finance in the United Kingdom.

None of these institutions has been affected by the global financial crisis, and their resilience bodes well for the future (11).

The launching of the multi-million dollar Halal investment company in London is one indicator of the growing salience of Islamic banking institutions in the West. Certain western banks have evinced interest in starting Islamic banking schemes. These include Goldman sashes, Kleinwort Benson and ANZ Grindlays. Citybank also launched an Islamic bank in Bahrain. Several other Western financial institutions offer products that comply with Shariah law, including Citigroup, Deutsche Bank, HSBC, Lloyds TSB and UBS (8).

The Islamic finance sector was worth between 300 and 500 billion dollars as of September 2006, compared with 200 billion dollars in 2004. By the end of 2005, more than 300 institutions were managing assets worth around \$700 billion to \$1 trillion in accordance with Sharia, the Islamic law. The sector is growing by 27 percent per anum.

It is estimated that Islamic banking is growing at a rate of 10-15% per year and with signs of consistent future growth. It is understood that Islamic banks have more than 300 institutions spread over 51 countries, plus an additional 250 mutual funds that comply with the Islamic principles.

Besides its wide geographical scope, the expansion of Islamic finance has also been taking place across the whole spectrum of financial activities, ranging from retail banking to insurance and capital market investments.

With the recent ability to patent new methods of doing business in the United States, a small number of patent applications have been filed on methods for providing Sharia compliant financial services. These pending patent applications include:

1- US patent US20030233324A1 Declining balance co-ownership financing arrangement. This discloses an allegedly Sharia compliant financing arrangement for home purchases and refinances that does not involve the payment of interest.

2- WO patent WO06068837A2 Controlling a computer system enabling Shariah-compliant financing. This discloses an improved computer system for carrying out Sharia compliant financial transactions (8).

Chapter 3

The Islamic economic system is under attack

The resurgence of the Islamic economic system in modern time seems to attract the enmity of certain Western writers in the west. These writers showed clearly that their information about the principles of Islamic economy is rather scanty or even nil. They proved without doubt that they are deliberately willing to neglect the well documented historical facts regarding the greatness of the Islamic economy with which the Islamic Empire which stretched over the Arabian Peninsula, most of Africa, South of Europe (Spain, South of France, and parts of Italy i.e. Sardinia and Cecily) as well as large parts of Asia, has managed quite successfully to rule over these vast parts of the world for hundreds of years. They are unaware or deliberately neglecting the fact that the Islamic economic system which proved successful for 800 years is essentially a capitalist one, and is the father of the present capitalist system (12). Although this fact maddens them and even incites their grudge against the Islamic economic system, I would add that it is a pity to see some contemporary academic economists in the West, who presumably have been raised on collecting the literature before conducting any scientific research, give themselves the right to talk unpleasantly about the Islamic economic system while they haven't the slightest idea about the references indicating clearly the contribution of the early Muslims to the world economy of the past until it developed to its present form. They but make me wonder: is that their attainment of knowledge? Their ugly separation from the historical literature makes their accusations erroneous, unscientific, and unacceptable. They put their people in the maze of ignorance by deliberately hiding the truth, thus bearing the sin of misleading their people either ignorantly or knowingly.

The Islamic economic system has been attacked for its alleged incoherence, incompleteness, impracticality and irrelevance (13), driven by cultural identity rather than problem solving (14). The false accusation reached to the extent of maliciously claiming that the Islamic economics does not go back to the Prophet of Islam but is an invented tradition that first emerged in the 1940's in India (15). Others have dismissed it as a hodgepodge of populist and social ideas in theory and nothing more than inefficient state control of the economy and some ineffective redistribution policies in practice (16). It is strange to see that the difficulties facing the Islamic economy nowadays while trying to reestablish itself via the modern financial tools in an unIslamic environment are considered by the attackers as elements of failure! By doing this, they first deliberately deceive themselves, and second, they intentionally mislead their readers. Because of their incognizance, obstinacy, and fear of its justice, as well as its threat to their boundless self-centeredness, and greed, they charge the Islamic economic system with the accusation that it falls short of successfully treating the more complicated daily economic issues. These deliriums are meant to turn the attention of Muslims and others from adopting an economic system that frees humanity from exploitation, injustice and avarice and leads it to an economic life of welfare, where man finds comfort, care and dignity.

I would say to those western economists attacking Islam that seventeen years after the dissolution of the Soviet Union, an event which supposedly signaled the definitive and irreversible triumph of global capitalism, the world economy today is in

shambles. The numerous failure of the capitalist economic system during the 20th century and its recurrence early in the third millennium (2007-2009) showed again and again, but this time with brutal clarity that, the capitalist system of the west is incompetent in fulfilling the basic needs of human populations.

Referring to the defects of the capitalist system mentioned earlier, as well as its frequent failure in the 20th century, in addition to the current economic crisis happening today in the third millennium, I wonder what these western economists would say about the validity of their economic system which they praise and glorify every minute of the day?

This disdain attack on Islamic economy, as well as the ludicrous notion that, "there is no distinctly Islamic way to build a ship, or defend a territory, or cure an epidemic, or forecast the weather, so why money" (15), is nothing but absurdity. To trifle with the Islamic economy with such unscientific and factitious statements is certainly aiming at perverting the readers from the truth. Muslims usually find behind these attacks either ignorance or a hidden political agenda prepared by the enemies of Islam to ridicule the religion and its principles.

This flimsiness, in addition to those maddened by the fact that Islamic economic thinking over the ages inspired Adam Smith's 'Wealth of Nation', compels me to uncover the forge and disclose the truth. This might hopefully add to their poor knowledge what they ought to know.

The contribution of the Islamic economic system throughout the ages to the present conventional economic system

Islamic finance was practiced predominantly in the Muslim world throughout the Middle Ages, fostering trade and business activities. In Spain and the Mediterranean and Baltic States, Islamic merchants became indispensable middlemen for trading activities. Many concepts, techniques, and instruments of Islamic finance were later adopted by European financiers and businessmen.

I was really fascinated by the outstanding article of the Islamic economist Dr. Umer Chapra (17). I couldn't find better than this article in refuting the false accusations that the Islamic economic system is an invented new tradition and does not go back to the time of the Prophet. The author introduced documented scientific evidences revealing the maladies of the present capitalist system, criticism of the capitalist system forwarded by well-meaning western scholars, the fallacy of the 'great gap theory', and the outstanding contribution of Islamic economies throughout the ages to the present conventional economy. I advise western economists to read this valuable article in order to compensate what is missing in their economic background. The following is a summary of some of the documented evidences forwarded by Dr. Chapra, revealing the truth about the Islamic economy. I will summarize the issues of his article in the following points:

1- Maladies of the capitalist system

There is no doubt that, in spite of its secular and materialist worldview, the market system led to a long period of prosperity in the western market oriented economies.

However this unprecedented prosperity did not lead to the elimination of poverty or the fulfillment of everyone's needs even in the wealthiest countries. Inequalities of income and wealth have also continued to persist and there has also been substantial degree of economic instability and unemployment which have added to the miseries of the poor. This indicates that both efficiency and equity have remained elusive in spite of the rapid development and phenomenal rise in wealth.

2- Criticism of the capitalist economic system by eminent Western scholars

There has been therefore persistent criticism of the capitalist economic system by a number of well-meaning scholars, including Thomas Carlyle (*Past and Present*, 1843), John Ruskin (*Unto this Last*, 1862) and Charles Dickens (*Hard Times*, 1854-55) in England, and Henry George (*Progress and poverty*, 1879) in America. They ridiculed the dominant doctrine of Laissez-Faire with its emphasis on self-interest. Thomas Carlyle called economics a "dismal science" and rejected the idea that free and uncontrolled private interests will work in harmony and further the public welfare. Henry George condemned the resulting contrast between wealth and poverty and wrote: "So long as all the increased wealth which modern progress brings goes but to build great fortunes, to increase luxury and make sharper the contrast between the House of Have and the House of Want, progress is not real and cannot be permanent (18).

In addition to failing to fulfill the basic needs of a large number of people and increasing inequalities of income and wealth, modern economic development has been associated with the disintegration of the family and a failure to bring peace of mind and inner happiness (19, 20, 21, 22, 23, 24, and 25).

3- Ethics in economy is indispensable

Most observers have concluded that government intervention cannot by itself remove all socio-economic ills. It is also necessary to motivate individuals to do what is right and abstain from doing what is wrong. This is where the moral uplift of society can be helpful. Without it, more and more difficult and costly regulations are needed. Nobel-laureate Amartya Sen has therefore, rightly argued that "the distancing of economics from ethics has impoverished welfare economics and also weakened the basis of good deal of descriptive and predictive economics" and that economics, "can be made more productive by paying greater and more explicit attention to ethical considerations and shaped human behavior and judgment" (26).

Shrewd Western observers came to the bitter conclusion that mankind will destroy itself, and the globe with it unless it rediscovers religion. Deniel Bell, Harvard Professor of sociology, already in 1976 discovered that capitalism in the long run is self-destructive because its very economic success poisons the virtues on which the economy is built. In his book "The cultural contradictions of Capitalism" Bell pleaded for the re-adoption of some sort of religion, even If one had to invent a new one for the purpose of re-establishing morality.

Equally perceptive was another devastating critique of Western civilization, written by the American ex-diplomat William Ophuls. In his "Requiem for Modern Politics – the Tragedy of the Enlightenment and the challenges of the new millennium in 1997"

predicted that occident will collapse, like communism before it, as a result of its lack of a compelling vision.

Both observers re-discovered that no human civilization ever survived without spirituality.

The view of Laureate and several others regarding the importance of ethics in economy is nothing new, because as explained before, it conforms to what Islam called for 1425 years ago.

Due to these problems and others the laissez-faire approach lost ground, particularly after the great depression of the 1930s.

4- The fallacy of the great gap

There is a big illusion embedded in the western literature that there is a great gap of over 500 years (Arab civilization epoch) between the Greeks and the mediaeval western scholars of the age of the Renaissance. This incorrect statement that the intervening period between the Greeks and the scholastics was sterile and unproductive was claimed by several authors in the west (27). Todd Lowry however, has rightly observed, "The character and sophistication of Arabian writings has been ignored" (28).

In fact, Muslim civilization made rich contributions to the socio-economic thought during what is called the "Great Gap" period, and thereby paved the way to the age of the Renaissance. The Western scholars were dramatically influenced by the contributions made by Muslim scientists in all fields of science including economics. The names of Ibn Sina (well known in the west as Avicenna, d. 1037), Ibn Rushd (well known in the west as Averroes, d. 1198) and Maimonides (d. 1204), a Jewish philosopher, scientist and physician who flourished in Muslim Spain, appear in almost every page of the thirteenth-century summa (treatises written by western scholastic philosophers (29).

Important early Muslim scholars who wrote about economics include: Abu Hanifah, Abu Yusuf (d. 798), Ishaq bin Ali al-Rawhi (d. 854), al-Farabi (d. 873), Qabus (d. 1012), al-Mawardi (d. 1058), Ibn Hazm (d. 1064), al-Sarakhsi (d. 1090), al-Tusi (d. 1093), al-Ghazali (d. 1111), al-Dimashqi (d. after 1175), Ibn Rushd (d. 1187), Ibn Taymiyyah (d. 1328), Ibn al-Ukhuwwah (d. 1329), Ibn al-Qayyim (d. 1350), al-Shatibi (d. 1388), Ibn Khaldun (d. 1406), al-Maqrizi (d. 1442), al-Dawwani (d. 1501), and Shah Waliyullah (d. 1726). Their insight into some economic concepts was so deep that a number of the theories propounded by them could undoubtedly be considered the forerunners of some more sophisticated modern formulations of these theories. This fact was confirmed by several Western investigators and others. For further details see Chapra (17).

It is not possible of course to provide comprehensive coverage of all the contributions Muslim scholars have made to economics. Only some of the contributions will be highlighted here to remove the concept of the fallacy of the "Great Gap".

5- Multidisciplinary dynamic approach for development

The multidisciplinary approach that was newly introduced to modern western research was first adopted by the early Muslim scholars. Muslim scholars did not focus their attention primarily on economic variables. They considered overall human well-being to be the end product of interaction over a long period of time between a number of economic, moral, social, political, demographic and historical factors in such a way as none of them is able to make an optimum contribution without the support of the others. Justice occupied a pivotal place in this whole framework because of its crucial importance in the Islamic worldview. There was an acute realization that justice is indispensable for development and that, in the absence of justice, there will be decline and disintegration (27).

The contribution made by the different Muslim scholars over the centuries seem to have reached their culmination in Ibn Khaldun's *Muquaddima*, which literally means 'Introduction', and constitutes the first volume of a seven-volume history called *Kitab al- Ibar* or the Book of Lessons (of history) (30, 31).

Ibn Khaldun discussed in his book what he called 'asabiyya (social cohesion), which he sourced as the cause of some civilizations becoming great and others not. He felt that many social forces are cyclic, although there can be sudden sharp turns that break the pattern. His idea about the benefits of the division of labor also relate to *asabiyya*, the greater the social cohesion, the more complex the successful division may be, the greater the economic growth. He noted that growth and development positively stimulates both supply and demand, and that the forces of supply and demand are what determines the prices of goods. He also noted macroeconomic forces of population growth, human capital development, and technological development effects on development. He thought that population growth was directly a function of wealth (8).

Ibn Khaldun sees that the well being of the people is not dependent just on economic variables, as conventional economics has emphasized until recently, but also on the closely interrelated role of moral, psychological, social, economic, political, demographic and historical factors. One of these factors acts as the trigger mechanism. The others may, or may not, react in the same way. If the others do not react in the same direction, then the decay in one sector may not spread to the others, and either the decaying sector may be reformed or the decline of the civilization may be much slower. If, however, the other sectors react in the same direction as the trigger mechanism, the decay will gain momentum through an interrelated chain reaction such that it becomes difficult over time to identify the cause from the effect. He, thus, seems to have had a clear vision of how all the different factors operate in an interrelated and dynamic manner over a long period to promote the development or decline of a society.

Ibn Khaldun did not, thus adopt the neoclassical economist's simplification of confining himself to primarily short-term static analysis of only markets by assuming unrealistically that all other factors remain constant. Even in the short-run, everything may be in a state of flux through a chain reaction to the various changes constantly taken place in human society, even though this may be too small as to be imperceptible. Therefore, even though economists may adopt the *ceteris paribus*

assumption for ease of analysis, Ibn Khaldun's multidisciplinary analysis can be more helpful in formulating socio-economic policies that help improve the overall performance of a society. Neoclassical economics is unable to do this, because, as North (27) has rightly asked, "How can one prescribe policies when one does not understand how economies develop?" He, therefore, considers neoclassical economics to be "an inappropriate tool to analyze and prescribe policies that will induce development (17).

Dr. Capra described in his article parts of the work of Ibn Khaldun, and several other Islamic scholars in some detail. This included the fields of the division of labor, specialization, trade, exchange and money and banking, demand and supply, public finance (taxation), public expenditure, economic mismanagement and famine, and stages of development. For further reading it is highly advisable to resort to Dr. Chapra's article.

6- Islamic capitalist market economy

The origin of capitalism and free markets can be traced back to the Islamic golden age and Muslim agricultural revolution (32), where the first market economy and earliest forms of merchant capitalism took root between the 8th-12th centuries, which some refer to as "Islamic capitalism" (33). A vigorous monetary economy was created on the basis of the expanding levels of circulation of a stable high-value currency (the dinar) and the integration of monetary areas that were previously independent. Innovative business new techniques and forms of business organizations were introduced by economists, merchants, and traders during this time. Such innovations included the earliest trading companies, big businesses, contracts, bills of exchange, long-distance international trade, the first forms of partnerships (mufawadah) such as limited partnerships (mudaraba), and the earliest forms of credit, debt, profit, loss, capital (al-mal), capital accumulation (nama al mal) (34), circulating capital, capital expenditure, revenue, cheques, promissory notes (35), trusts (Waqf), savings accounts, transactional accounts, pawning, loaning, exchange rates, bankers, money changers, ledgers, deposits, assignments, the double- entry bookkeeping system (32), and lawsuits (36). Organizational enterprises similar to corporations independent from the state also existed in the medieval Islamic world (37, 38). Many of these capitalist concepts were adopted and further advanced in medieval Europe from the 13th century onwards (34).

The system of contract relied upon by merchants was very effective. Merchants would buy and sell on commission, with money loaned to them by wealthy investors, or a joint investment of several merchants who were often Muslim, Christian and Jewish. Business partnerships would be made for many commercial ventures, and bonds of kinship enabled trade networks to form over huge distances. Networks developed during this time enabled a world in which money could be promised by a bank in Baghdad and cashed in Spain, creating the cheque system of today. Each time items passed through the cities along this extraordinary network, the city imposed a tax, resulting in high prices once reaching the final destination. The innovations made by Muslims and Jews laid the foundations for the modern economic system (8).

To finance their expanding domestic and international trade, the Muslim world also developed a financial system, which was able to mobilize the entire reservoir of

monetary resources of the medieval Islamic world in order to finance agriculture, crafts, manufacturing and long-distance trade (39). Financiers were known as Sarrafs. By the time of Abbasid Caliph al-Muqtadir (908-32), Muslims had started performing most of the basic functions of modern banks (40). They had their markets, something akin to the Wall Street in New York and Lombard Street in London, and fulfilled all the banking needs of commerce, agriculture and industry (41). This promoted the use of cheques (sakk) and letters of credit (hawala). The English word cheque comes from the Arabic term sakk (17).

It is a well established fact that sciences in all fields progressed rapidly in the Muslim world for four centuries starting from the middle of the eighth century to the middle of the twelfth century and continued to do so at a substantially decelerated pace for at least two more centuries, tapering off gradually thereafter (42). As indicated by Todd Lowry in his 'foreword' in Ghazanfar (28), "Muslims were the torch bearers of ancient learning during the medieval period" and "it was from them that the Renaissance was sparked and the Enlightenment kindled." Watt has been frank enough to admit that, "The influence of Islam on western Christendom is greater than is usually realized" and that, "an important task for western Europeans as we move into the era of the one world is...to acknowledge fully our debt to the Arab and Islamic world" (43).

With such well documented historical evidences regarding the contribution of the Muslim world to the economic system of today, there is no need to allow the 'Great Gap' concept to persist. It would help promote better understanding of Muslim civilization in the west if text books started giving credit to Muslim scholars (17). Also there is no need to falsely claim that the Islamic economic system does not go back to the time of the Prophet and the early Muslims but to the time of the early 1940s, because a false statement like this is but the denial of the malevolent and the rejection of the ignorant.

Global financial crisis and Islamic banking.

From the medieval period, we move to the third millennium to watch the performance of the Islamic economy in modern time.

The international financial crisis began in 2008 and intensified over the past few months in 2009. The International Monetary Fund warned that this credit crisis will result in losses of over one trillion dollars and that it may worsen especially that the 150-year-old US financial giant Lehman Brothers declared bankruptcy not to mention the sale of financial services firm Merrill Lynch to the Bank of America.

Before the international financial crisis, Islamic banking was marginalized and disregarded by international institutions. Western financial institutions considered the Islamic banking system to be simple and rudimentary, and not attuned to the modern times and new financial developments such as the innovative and complex financial tools that have dazzled the world. These financial apparatus are based upon mathematical equations and theories formulated by the fore-most mathematicians in the world, some of whom are noble laureates hired by large financial institutions to help boost their performance.

However, the financial crisis has revealed to the world the invalidity in many of the assets and theories and mathematic equations upon which much of the modern financial system is based. Revealing also that these were the main factors behind the creation, spreading, and impact of the financial crisis, the likes of which the world has not seen before.

As the financial crisis worsened, observers began to notice the stability and resilience of Islamic financial institutions, and no Islamic financial institute has yet to declare losses in the financial securities and bonds that were a major cause of the crisis. On the contrary, many Islamic institutions have announced an increase in profits, which resulted in many commending the principles upon which the Islamic banking is based, and the Islamic laws that regulate it, calling for its introduction to rectify the global financial system.

There have been calls for the conventional banking industry to take a leaf out of the book of Islamic finance. Perhaps the most recent and strongest of these calls was reported in the Bloomberg Agency's report which revealed that the Vatican had stated that western banks should carefully examine Islamic financial regulations in order to restore confidence amongst their clients at a time of international economic crisis (44).

As a result of the financial crisis, financial institutions in the developed world lined up for large state assistance. The Islamic banks however, emerged unscathed from the crisis. No Islamic bank has failed and has needed government recapitalization which ultimately becomes a burden on hard pressed taxpayers?

There is no doubt that the western economy lacks a stronger ethical orientation. If the rules of Islamic financing had been in place, the sub prime mortgage crisis in the USA, which triggered the current financial crisis, could never have happened. If the details had been closely inspected, it would have been evident in many cases that the people taking out the mortgage would never been in a position to repay it.

Similarly, short selling whereby money is earned not by selling goods or providing services, but by cleverly using capital to generate major profits (or major losses, as the case may be) – would have been prevented.

In Islam it is prevented to trade in pork, alcohol, pornography, or gambling. This last ban not only applies to doing business with casinos, but certainly also to gambling-like behavior on the international finance markets, where conventional rules of economics were abandoned and where 'financial products' that were not even understood by many of those who were dealing in them suddenly appeared.

The collapse of the capitalist system based on usury and paper and not on goods traded on the market is proof that it is in crisis and shows that the Islamic economic philosophy is holding up.

Islamic banking scheme, which has proved its immunity against the current world economic recession and experienced tremendous growth amid global downturn, could be an example for the conventional capitalist financial system.

The reason behind this immunity is that all Islamic financial schemes prohibit greed, which is the root cause of the current global crisis.

One may ask: why Islamic banks withstood the recent turmoil?

The religious teaching underpinning Islamic finance is concerned with justice in financial contracts to ensure that none of the parties is being exploited.

Riba (interest or usury) is one source of exploitation, especially as in the case of sub-prime lending, the highest rates were charged to lower earners. Such discriminatory charging by conventional banks was justified as being a reflection of the risks involved.

Those on lower incomes, with poorer prospects of finding new employment in the event of redundancy, were less likely to be able to service their interest payments.

While loosely perceived as only interest free, Islamic finance has got a broader implication. Islamic finance shuns investments in gambling, and other games of chance, alcohol and pornography, uncertainty, and ambiguity in favor of ethical investments.

Because Islamic law (Sharia) prohibits the payment and collection of interest, which is seen as a form of gambling, so highly complex instruments such as derivatives, options or papers and other creative accounting practices that caused the meltdown are banned.

The soundness of Islamic banks is accounted for by the fact that they use a classical banking model, with financing derived from deposits, rather than being funded by borrowings from wholesale markets. Consequently when the credit crunch came and borrowing from wholesale markets was halted, Islamic banks were not exposed.

Transactions in Islam must be backed by real assets – not shady repackaged sub prime mortgages – and because risk is shared between the bank and the depositor there is an incentive for the institutions to ensure the deal is sound.

Investors have the right to know how their funds are being used, and the sector is overseen by dedicated supervisory boards as well as the usual national regulatory authorities.

Islamic banks do not rely on bonds and stocks and are not involved in the buying and selling of debt unlike most conventional European and Us banks.

While the conventional concept of financing deals in money and monetary papers, Islam on the other hand does not recognize money as subject matter of trade but rather only a medium of exchange.

Islamic housing finance involves risk sharing between the bank and the client, rather than transferring all the risk to the latter. When the financier contributes money on the basis of Musharakah and mudarabah, it is either converted into the assets having intrinsic utility or creates real assets. Profits are generated through the sale of these real assets. Islamic law does not object to payment for the use of an asset. The

earnings and profits or returns from assets are indeed encouraged as long as both lender and borrower share the investment risk together. The depositors in this case are not lenders or creditors; rather they are investors (45).

Under the most commonly used diminishing Musharaka (partnership) contract, the bank and the client form a partnership, with the bank providing up to 90 percent of the purchase price, and the client at least 10 percent.

Over a period of usually 10 to 25 years, the client buys out the ownership share of the bank which makes its profit from the rent paid by the client for the share the bank owns.

In the event of a rental or repayments default, the bank may advance the clients an interest-free loan (qard hassan in Arabic) to enable them to continue their payments during recession in anticipation that they will pay in full when the economy rebounds (11).

The clients retain their homes rather than being faced with eviction-like the victims of the sub-prime crisis.

Islamic banks enjoy a built-in stabilizer to help them cope with economic downturns, as instead of paying interest to depositors, those with investment Mudaraba accounts share in the bank's profits.

Thus, if profitability declines in an economic downturn, depositors receive lower returns, but if profits rise they enjoy higher returns.

This profit sharing reduces risk for the banks and means they are less likely to become insolvent. However as the bank build up a profit equalization reserve, which can be used to finance pay-outs during difficult years, depositors benefit from some protection of their returns during economic downturns (11).

Investors seeking Sharia compliance have portfolios which are more heavily weighted in sectors such as healthcare or utilizes where revenue streams are maintained even during cyclical down-turns.

The banks in the United States charged high arrangement fees for sub-prime borrowers which were used to pay bonuses for those signing up new clients.

As the mortgages were sold on to Freddie Mac and Fanny Mae, the arrangers were unconcerned that the sub-prime borrowers might be unable to meet their financial obligations.

Indeed, gifts were provided to entice the feckless to sign up, and the mortgages often exceeded the value of the property.

The banks in other words became more booking agents, with no long term commitment to their clients.

In addition to banking, Islamic Sukuk security insurance has enormous potential. Unlike conventional bonds and notes, Sukuk are backed by real assets, which provides assurance to investors.

Although global Sukuk markets were adversely affected by the global recession in 2008, longer term prospects look promising, with the United Kingdom authorities promoting London as an international centre for Sukuk issuance to rival Bahrain, Dubai, and Kuala Lumpur.

There can be no doubt that Islamic finance has an exciting future, and the quest for a financial system based on moral values rather than greed and fear, is bound to enhance its position in the global system (11).

References cited

- (1) Economic Justice: Islam versus capitalism.
Muhammad Malkawi. March 28, 2002.
abutalha@ yahoo.com.
- (2) Decomposing World Income Distribution: Does the World have a Middle Class?
Branko Milanovic and Shlomo Yitzhaki.
- (3) What do we really want?
Economic Growth is seen as good, yet it makes many in the rich world miserable.
George Monbiot, Tuesday, August 27, 2002.
- (4) Calls for a "Kinder Capitalism".
Bill Gates.
[http:// www. Slashdot.org/article](http://www.Slashdot.org/article).
- (5) Global Crisis – financial and environmental – and solution.
[http:// binary economics.net/global-financial-crisis-and solution](http://binaryeconomics.net/global-financial-crisis-and-solution).
- (6) The Religion of Islam – The Economic System of Islam (part 2 of 2): Its ideology.
[http:// www. islamreligion.com/articles](http://www.islamreligion.com/articles).
- (7) The Foundations of Islamic Finance – Finance in Islam.
M.N. Siddiqi.
[http:// financeinislam.com/article](http://financeinislam.com/article).
- (8) Islamic Economic Jurisprudence – Wikipedia, the free encyclopedia.
[http:// en.wikipedia.org/wiki/Islamic-economical-jurisprudence](http://en.wikipedia.org/wiki/Islamic-economical-jurisprudence).
- (9) Islamic Finance and Beyond.:
Premises and Promises of Islamic Economics.
Muhammad Nejatullah Siddiki.
[http:// soundvision-com/info/money/islameconomocs.asp](http://soundvision-com/info/money/islameconomocs.asp).
- (10) The Principal Instruments of Islamic Political Economy.
Masudul Alam Choudhury.
[http:// Islamic-finance.net/Islamic-economy/ Chapt. I](http://Islamic-finance.net/Islamic-economy/Chapt.I).
- (11) Why Islamic Banking is successful?
Islamic banks are unscathed despite of financial crisis.
Prof. Rodney Wilson – Professor-Durham University.
[http:// www. islamonline.net/servlet/satellite](http://www.islamonline.net/servlet/satellite).
- (12) Property Rights and Contemporary Islamic Thought – Review of Social Economy. Summer 1989, Vol. 47, PP. 185-280, and historically is the father of the present capitalist system.
Sohrab Bebadá.

- (13) Marty and Apply – Fundamentalisms and the State, University of Chicago Press, 1993, PP. 302-41.
Timur Kuran.
- (14) The Discontents of Islamic Economic Mortality, American Economic Review, 1996.
Timur Kuran.
- (15) Islam and Mammon: The Economic Predicaments of Islamism. Journal of Third World Studies. Princeton and Oxford: Princeton University Press, 2004, PP. 194.
Timur Kuran.
- (16) Halliday, Fred, 100 Myths about the Middle East. Saqi Books, 2005, PP. 89.
- (17) EH. Net encyclopedia: Islamic Economics: What It Is and How It Developed. M. Umer Chapra, Islamic Research and Training institute.
<http://eh.net/encyclopedia/article/Chapra.islamic>.
- (18) Progress and poverty.
George, Henry.
New York: Robert Schalkenback Foundation, 1955.
- (19) Does Economic Growth Improve the human Lot? Some Empirical Evidence. In Nation and Households in Economic Growth.: Essays in honor of Moses Abramowitz, edited by Paul David and Melvin Reder. New York; Academic press, 1974.
By: Easterlin Richard.
- (20) Will Raising the Income of All Increase the Happiness of All?
Journal of Economic Behavior and Organization 27, No. 1 PP. 35-48, 1995.
By: Easterlin Richard.
- (21) Income and Happiness: "Towards a unified theory" in Economic Journal, 111: 473 (2001).
By: Easterlin Richard.
- (22) Happiness and Economic Performance. Economic Journal 107, No. 445, PP. 1815-31, 1997.
By: Oswald, A.J.
- (23) Well-being over time in Britain and USA.
NBER, working paper No. 7487, 200.
By: Blanchflower, David and Andrew Oswald..
- (24) Money and Happiness: Income and Subjective Well-being. In Culture and Subjective Well-being, edited by E, Diener and E, Suh. Cambridge, MA: Press, 2000.
By: Diener, E. and Shigehiro Oshi.

- (25) Does Growth Cause Happiness, or Does Happiness Cause Growth? *Kyklos* 52, No. 1, PP. 3-26, 1999.
By: Kenny, Charles.
- (26) *Poverty and Famine. An Essay on Entitlement and Deprivation.* Oxford: Clarendon Press, 1981.
By: Sen, Amartya.
- (27) Economic Performance Through Time. *American Economic Review* 84, No. 2, PP. 359-68, 1994.
By: North, Douglas C.
- (28) *Medieval Islamic Economic Thought: Filling the Great Gap in European Economics.* London: Routledge Cuzzon, 2003.
By: Ghazanfar, S.M..
- (29) Scholasticism. *Encyclopedia Britannica* 16, PP. 352057, 1978.
By: Pifer, Joseph.
- (30) Ibn Khaldun, "The Father of Economics", *Arab Civilization: Challenges and Responses*, New York University Press, ISBN 0887066984.
By: I.M.Oweiss, 1988.
- (31) Ibn Khaldun: A Fourteenth Century Economist. *The Journal of political Economy* 79 (5): PP. 1105-1119.
By: Jean David C. Boulakia, 1971.
- (32) *The Cambridge Economic History of Europe*, PP. 437. Cambridge University Press, ISBN 052 1087090.
- (33) Capitalism in Medieval Islam. *The Journal of Economic History* 29 (1), PP. 79-96 [81, 83, 85, 90, 93, 96].
By: Subhi Y. Labib.
- (34) Islam, the Mediterranean Materialism 15 (1), PP: 47-74, Brill Publishers.
By: Jairus Banaji.
- (35) *Medieval Trade in the Mediterranean World: Illustrative Documents*, Columbia University Press, ISBN 0231123574.
By: Robert Sabatino Lopez, Irving Woodworth Raymond, Olivia Remie Constable (2001).
- (36) The History of the Peer-Review Process, *Trends in Biotechnology* 20 (8), PP: 357-358.
By: Ray Spier (2002).
- (37) *The Law, Agency and Policy in Medieval Islamic society: Development of the Institutions of Learning from the Tenth to the Fifteenth Century.* *Comparative studies in Society and History* 41, PP: 2693. Cambridge University Press.
By: Said Amir Arjomand (1999).

- (38) The Arab Nation: Some Conclusions and Problems.
MERIP Reports 68, PP: 3-14 [8, 13].
By: Samir Amin (1978).
- (39) Partnership and Profit in Medieval Islam. Princeton, NJ: Princeton University Press, 1970. By: Udovitch, Abraham L.
- (40) In Encyclopedia of Islam, Vol. 2 PP. 382-83. Leiden: Brill, 1992.
By: Fishel, W. J. Djahladh.
- (41) Baghdad. The Encyclopedia of Islam, PP: 894-99. Leiden: Brill, 1986.
By: Duri, A.A.
- (42) Introduction to the History of Science. Washington, D.C: Carnrgie Institute.
Three volumes issued between 1927 and 1984, each of the second and third volumes has two parts.
By: Sarton, George.
- (43) The Influence of Islam on Medieval Europe. Edinburgh.
Edinburgh University Press, 1972.
By: Watt, W. Montgomery.
- (44) The Financial Crisis: A Golden Opportunity for Islamic Banking.
By: Lahem al Nassar.
[http: // www. the financial express-bd.com](http://www.thefinancialexpress-bd.com).
- (45) Islamic banking remains almost unhurt in global financial crisis.
Iqbal Ibrahim Ka
Karmally, coordinator o
[http: //. The financial express-bd.com](http://.Thefinancialexpress-bd.com).

