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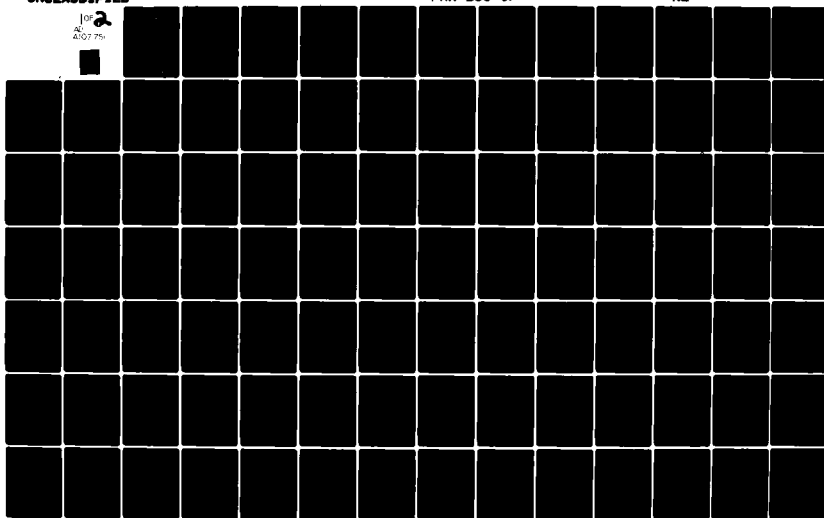
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# ISLAMIC COMMERCIAL LAW IN CONTEMPORARY ECONOMICS

by Robert Dickson Crane

## PART I

### INTRODUCTION

#### I. POLICY CONTEXT

The Islamic ideological revolution in Iran is the most obvious manifestation of a deep-seated groundswell of both revolution and reform throughout the Muslim world from the Phillipines to Morocco. The high tide of Westernization passed during the decade of the 1970's. What may follow it still lies in the future. As yet, the impact of the Islamic reform movement on business and government policy has not been studied outside of the closed circles of Muslim elites.

The Islamic reformers are attempting to create entirely new Islamic economic institutions in the fields of money and banking and fiscal policy management. In this economic realm, but less so in the field of political change, the reformers are gaining either active or passive support of the political leadership in almost every country of the Middle East. This section, entitled "Islamic Commercial Law in Contemporary Economics," describes what these new Islamic institutions are, and why, and what impact they may have on the future of U.S. business in the Middle East. This impact, in turn, will affect the political environment of the U.S. pursuit of its broader strategic interests in this part of the world.

## II. ISLAMIC ECONOMICS

The intellectual focus of the changes now getting underway in the economic infrastructure of society in the Middle East is a new discipline known as "Islamic Economics." This differs from economics as understood in the West, because Islamic economics focuses equally on economic growth and on distributive justice, that is, on efficiency in producing wealth and on effectiveness in distributing it justly among the producers and among those who, through no fault of their own, cannot participate in the production process.

Islamic economics, like the Islamic law which informs and governs it, is a complete code of human life. Like Islam itself, it is both temporal and spiritual in focus, and it is both a belief and a practice. Islamic economics is not merely descriptive, seeking to discover "laws" governing the material aspects of human behavior with the finality of a physical science. Instead Islamic economics focuses on human free will. It is purposive and normative, designed to engineer the institutions of society in order to create an optimum climate for every man to live as a moral being.

Islamic economics is a strategy for social engineering, designed to create an Islamic societal model in every country governed by Muslims, adapted to the unique culture, customs, natural resources, and geographical location of each society. Although all economics is value-loaded, Islamic economics is proudly so. The Islamic reformers have a mission to perceive and implement "the divine pattern relevant to man's economic life."

Islamic economics does not study society as it is, because the present situation is considered to be morally unacceptable and therefore not a proper base from which to forecast or design change. Muslim economists and

legal scholars emphasize their commitment to a religion in which the highest good is justice, both in men's relations with God and by derivation therefrom in their relationships as equals with each other. Therefore, in the words of the leading observer of Islamic economics, Dr. Muhammad Nejatullah Siddiqi, now at the International Centre for Research in Islamic Economics in Jeddah, Saudi Arabia: "The task of Islamic economics lies in building bridges between the is and the ought." The base case is the future, not the past.

In the single most significant publication in the field, Studies in Islamic Economics, which is the proceedings of the First International Conference on Islamic Economics, held in 1976 in Mecca, Saudi Arabia, the American scholar, Dr. Mahmud Abu Saud, writes: "There is no Islamic economics per se unless there is an Islamic ideology prevailing and applied in a Muslim community." In fact, no Muslim country can be considered Islamic until it implements Islamic economics. There is no Islamic country in the world today.

The centers of influence in Islamic economics are research institutions in Pakistan, Saudi Arabia, the United States, and England, and universities in all the major Muslim countries. The leading research institutions, in order of prestige, are:

Pakistan

The Council of Islamic Ideology, Islamabad  
The Institute of Policy Studies, Islamabad  
The Pakistan Institute of Development Economics, Islamabad

Saudi Arabia

International Centre for Research in Islamic Economics, Jeddah

United States

Association of Muslim Social Scientists, Indiana

England

The Islamic Foundation, Leicester

The leading university programs in Islamic economics, in alphabetical order, are:

|               |                                             |
|---------------|---------------------------------------------|
| Egypt:        | Al Azhar                                    |
| Indonesia:    | Islamic University, Bandung                 |
| Jordan:       | University of Jordan, Amman                 |
| Pakistan:     | University of Karachi                       |
|               | University of Punjab, Lahore                |
| Saudi Arabia: | King Abdul Aziz University (Jeddah & Mecca) |
| Sudan:        | Umm Durman University                       |
| UAE:          | Al Ain University, Abu Dhabi                |

The products of these and other centers are summarized in Dr. Muhammad Nejatullah Siddiqi's masterful, 78-page analytical "Survey of Contemporary Literature," which accompanies his bibliography of 700 major works on Islamic economics and is published in the above-mentioned book, Studies in Islamic Economics, edited by the leading Pakistani intellectual, Khurshid Ahmad.

All of the above research and educational institutions are distinguished by their vigor in pursuing: 1) the goal of an entirely new Islamic paradigm for man's economic life, and 2) the process or strategy of achieving this goal through "comprehensive system transformation." Although Libya and Iran have tried to be leaders in the field, only the above institutions are committed, and supported by their governments, to transform society through reform rather than revolution.

### III. SOCIO-POLITICAL CONTEXT

The significance for the United States of Islamic economics and of the reform movement which has spawned it can be understood only by first placing Islamic reform within a framework of challenge and response in the Middle East. The mainspring of history both now and throughout the past 1400 years in the Middle East has been the concept of justice. Specifically, continuity and change in the history of the Muslim world depends on whether justice, which is the core concept of Islam, is challenged either from within the Middle East or from without. The four responses, which in one combination or another control events in every country of the Middle East, are:

A. Taglid, which is a negative, reactionary retreat into the externals of the past. This is typified by the Khomeini movement in Iran, particularly in its reaction against the diametrically opposite response of President Bani Sadr. Taglid is a traditionalist opposition to change of any kind and to all agents of change. It is triggered by a fear that change, especially under foreign influence, is a potential agent of injustice and therefore must be destroyed.

This response to a perceived challenge to justice is a mechanical interpretation of past authority without reference to the values that originally gave rise to this authority or to the new values that may challenge it. This is really a failure to respond to change and thus is a failure to cope. This is the precise opposite of the response that triggers Islamic economics and the institutional changes now evolving from it.

B. Thawra, which means revolution and in this categorization of responses to lack of justice consists of the revolutionary search for secular utopias.

This is a radical acceptance of a totally new set of materialistic and utilitarian values, now emanating out of the USSR or China and typified at present only by some extremist Palestinian terrorists based mainly in the PDRY. This is rare in the history of the Middle East though its threat is potentially severe, as it was during the Mutazillite attempt to stave off the assault of pure Greek rational secularism a millenium ago.

C. Islah, which means reform and is used here to denote modernist adaptation. This is an intellectual attempt to restore coherence of world view through a synthetic integration of Islam and the challenging thoughts and institutions of an encroaching culture. This response reached its peak in the great flowering of Westernization beginning with Abduh in 19th century Egypt, but was first preceded in prototype by the Mutazillite movement during the classical Abbasid Caliphate in Baghdad. This response attempts to infuse Islamic values into Western institutions or else to infuse Western values into traditional Islamic institutions. In fact, these two infusions in sequence summarize the process whereby the Shari'a (Islamic law) was gradually displaced by administrative law (Siyasa) and modern commercial codes from 1820 up to about 1960.

D. Tajdid, which means renewal. Those who are promoting the new Islamic institutions in banking, insurance, and fiscal management, and generally throughout the fields of law and business, universally use this term to describe their movement. This is a moral response to the challenge of moral decline. Tajdid is the comprehensive and holistic application of a civilization's original values in order either to fill a vacuum, or to counter internal perversions (such as extreme, nihilistic Sufism), or to displace

any challenging foreign values.

This has been the dominant response to the various challenges to justice in the history of the Middle East. Its most illustrious representatives include the Prophet Muhammad himself; al Ghazali, the greatest of Islam's intellectuals, who lived eight centuries ago; Abdul Wahhab of Arabia and Shah Wali Allah of Mughul India who interacted two centuries ago to found the modern movement of Tajdid; and Maulana Maududi of Pakistan and Bani Sadr, President of Iran, who have written the major classics that have brought Islamic economics to the forefront of change in the Middle East today. These classics are almost unknown in the West. Bani Sadr's comprehensive study of Islamic economics, incredibly, has never even been translated into English, though the Europeans have been reading it in French for years.

The meaning and future of contemporary economics in the Middle East generally, and within each country, will be determined by competition among the above four responses to the fortunes of justice, because contemporary economics in the Middle East is synonymous with Islamic economics and with the reform movement that powers it.

#### IV. COMMERCIAL LAW FOR AMERICANS IN THE MIDDLE EAST

American business men dealing in the Middle East can expect to be thoroughly isolated from any direct contact with Islamic law or with Islamic economics. The leading law firm handling international business of all kinds with Saudi Arabia reported in 1981 that not once in the past five years, since it opened an office in Jeddah, has it had any occasion to deal with the local Shari'a courts or to know anything about their substantive and procedural operations.

Unique among American business operations in the Middle East is the experience of Aramco in building a separate "Aramco cultural community" as a necessary infrastructure to support its oil operations in Arabia. The long-term counsel for Aramco's internal operations, George M. Baroody, has described his twenty years of experience in the chapter, "The Practice of Law in Saudi Arabia," in Willard Beling's book, published last year, King Faisal and the Modernization of Saudi Arabia. Even in such an unusual situation, the occasions of contact with Islamic law were restricted largely to interpersonal relations, i.e. what we would call criminal law and torts. The regional and national governments carefully maintained business dealings even at the local level as special cases to be treated through administrative directives or through the personal discretion of senior Saudi officials.

More recently, when a case involving a default in interest payments by a Saudi to a foreign financier was brought before a Saudi Shari'a court, the rationale of public policy exempted this default from the Shari'a prohibition of interest. This exemption was in accord with Islamic practice going back 1400 years to the period of the model Medina State in the 7th century.

Americans dealing in the Middle East are entitled not only in practice but also in theory, which is much more important over the long run, to a special regime of law governing their status as foreigners. Islamic law in general is not territorial but personal. Every foreigner by tradition carries his own law around with him. Thus in Medina during the time of the Prophet Muhammad, if five merchants, each from a different country, concluded a business deal, they first had to agree on whose law would govern.

Only if all were Muslims, dealing in a Muslim country, would they have to abide by the law of Shari'a. In this case, the Shari'a or Islamic law would be the personal law of each one of them, regardless of what country each might have come from.

This special status of non-Muslims was protected assiduously in order to maintain the purity of Islamic law as a religious institution. Islamic law governs only those who accept it in their lives as the revealed will of God. This is why the Christians and Jews, as Ahl adh-Dhimma or People of the Book, and in Iran the Zoroastrians, and in India even the Hindus (who were elevated by some theologians from the status of Mushrikum - polytheists - to the general status of Kuffar - sing. Kafir or non-Muslim - and thence to the special non-Muslim status of Dhimmis, see glossary) each formed a separate community with its own legal system operating concurrently with the legal system of the Muslim rulers. During the period of the Ottoman Empire prior to World War I, these separate communities were known as Millets.

The mechanisms by which such special status is maintained in the modern Middle East vary from country to country. In Saudi Arabia and Oman, special arbitration tribunals have been created by the government with exclusive jurisdiction over all commercial dealings with foreigners. In the emirates of the Gulf and some other countries, the local businessmen have formed Chambers of Commerce and Industry with juridical power recognized by the local religious leaders. Although appeal to international arbitration courts in Europe was accepted occasionally during the 1970's, appeal now is generally restricted to the Divan or private secretariat of each ruler.

The laws governing American business in the Middle East are well summarized in a number of handy publications and exhaustively treated with complete translations in standard looseleaf services, the best of which appeared only after the revolution in Iran.

The best introductory summaries are by the U.S. Commerce Department's International Trade Administration (especially by the Commerce Action Group for the Near East, CAGNE) and by the private Intercrescent Publishing Company. Especially recommended are:

1) An Introduction to Contract Procedure in the Near East and North Africa, 89 pp., containing surveys for 18 countries, ed. Cherie A. Loustana, ITA. The 2nd edition, published in October 1980, contains a useful essay, entitled "Islamic Law and its Commercial Usage."

2) A Business Guide to the Near East and North Africa, 90 pp., ITA, February 1980.

3) Islamic Cultural Training Services Available to American Firms, 8 pp., Karl Reiner, ITA, September 1980.

4) Arab Markets 1978, Intercrescent Publishing Company, P.O. Box 8481, Dallas, Texas 75205: The participants, Nancy Shilling (Editor), Robert D. Crane (Adviser, Bahrain Finance Minister), Cordell Hull (Vice President, Bechtel International Corporation), Alan E. Moore (Director, Bahrain Monetary Agency), and Bart Paff (Advisor, Emir of Sharjah), covered business law and policy, including basic principles of Islamic law; business customs and practices; marketing; advertising; banking and finance; and industrial policies for small and large projects.

The President of Intercrescent, Nancy Shilling, provides a country by country summary of preferred policies on incorporation, agents, bidding, guarantee bonds, labor management, dispute settlement, real estate rights and obligations (e.g., in the UAE foreigners have only the right of usufruct and have no right to their own improvements), incentives for trade and business, and government policy and control mechanisms.

The best reference works on commercial law and practice in the Middle East are the following looseleaf compendia, selected from among 120 such works published by Oceana Publications:

- 1) Commercial Laws of the Middle East, edited by Allen P. Keese, Counsel, Overseas Private Investment Corporation; part of a planned worldwide translation series, entitled Commercial, Business, and Trade Laws: National Laws for Foreign Entities. Commenced publication in 1981 with six binders: I on Kuwait, II on Saudi Arabia, III on the Sudan, IV on Egypt, V on the Emirates and Algeria, and VI on Iran, Syria, Morocco, Tunisia. Covers contracts, sales, banking and bills of exchange, trade practices and consumer protection, company law, partnership, agency, public tender (bidding), investment, securities, and arbitration. \$600 or \$100 per binder.
- 2) Digest of Commercial Laws of the World, edited by George Kohlik, National Association of Credit Management, analytical summary of business laws on the subjects of the above translation series and also on courts' jurisdiction, recognition of foreign judgements, bankruptcy, attachments, liens, and statutes of limitations. \$575 per set.
- 3) International Tax Treaties of all Nations, ed. Diamond, 11 volumes on published treaties, 8 volumes on unpublished treaties, \$50 per volume, sold as a set.
- 4) Investment Laws of the World: The Developing Nations, the International Center for Settlement of Investment Disputes, 11 binders, \$800.
- 5) Transnational Economic and Monetary Law: Transactions and Contracts, ed. Leonard Lazar, 5 binders, \$375.
- 6) Product Liability, A Manual of Practice in Selected Nations, ed. Hans-Ulrich Stucki, started in 1980, 2 binders available @ \$100.
- 7) Bibliography: Multinational Corporations and Foreign Direct Investment, ed. Browndorf, 2 binders, available only as part of Multinational Corporations Law, ed. Kenneth Simmonds, 6 binders, @ \$75.
- 8) A Bibliography on Foreign and Comparative Law: Books and Articles in English, ed. Charles Szladits, Parker School of Foreign and Comparative Law, Columbia University, 3 bound volumes for 1972-1977, annual supplements, \$425 per set.
- 9) Catalogue of the Translator's Library of the Department of Trade and Industry, Her Majesty's Stationery Office, ed. G.E. Hamilton, 3 vols, \$270 set.

Specialized country services by Oceana Publications, which can be commissioned by individual firms or governments, include, for example:

- 1) The Banking Law of 1974, Sultanate of Oman, English/Arabic, one binder, regularly updated starting in 1975, \$40.
- 2) The Maritime Law of 1974, Sultanate of Oman, one binder in English, \$40, one in Arabic, \$30.

Commercial law for Americans in the Middle East is described at every level of specificity in the above publications. The thoroughness and convenience and timeliness of materials available on ordinary commercial law in the Middle East contrasts with the lack of such materials on Islamic commercial law. Quite simply, there are almost no Westerners, much less Americans, with any knowledge at all either of the Shari'a, i.e. Islamic law, as it is now developing in the Middle East or of Islamic economics, which, at least in concept, is merely a branch of the Shari'a.

The reason is simple. Islamic commercial law, almost by definition, is designed exclusively for Muslims. Muslims see no reason why this commercial law should concern non-Muslim Americans, and these Americans, at least in the past, have lived happily without ever knowing that Islamic commercial law even exists.

When the first book appears in Arabic, as it did in 1980 by an Egyptian professor at the Al Ain University in Abu Dhabi on the new discipline of Islamic Accounting, this is a great event in Islam. When the same author prepares a study on the experiences of the Sudan, Saudi Arabia, Dubai, and Sharjah in creating and operating in 1979-80 the first Islamic insurance companies in accordance with the Shari'a prohibition against Riba, Muslims from all over the world gathered at a conference to hear the author tell about the first practical experience in this new field of Islamic economics. But there is no intention to translate the book on Islamic accounting into English. And the success of the Islamic insurance companies and how they did it is treated as a family matter.

Again the reason is simple. The task of building Islamic economic institutions is a religious undertaking in the sense that everything a Muslim does should be a form of prayer and everything he does should be judged exclusively by divinely revealed moral values. The success of Islamic banks and insurance companies and even the effort to create them have meaning and a direct impact only on the Muslims who might want to use them.

Nevertheless, the Islamic institutions of Mudaraba banking and Zakat as a tool of fiscal policy, which are the two keys to Islamic economics and to the Islamic commercial law that is forming around them, may be critical to the economic and political future of every country in the Middle East. The implementation of Islamic economics and Islamic commercial law may have no direct impact on American businessmen at the micro level, but the success or failure of this implementation in each country of the Middle East at the macro level cannot fail to influence in a major way the overall business environment, for either better or worse.

Furthermore, Islamic commercial law in contemporary economics does concern non-Muslim Americans, simply because the peoples of America and the Middle East all share the same planet, and because the moral values underlying the institutions of Islamic economics are identical to the Christian values that underlie Western civilization, though the Muslim and Christian interpretation of these values for implementation may differ.

## PART II

### ISLAMIC BANKING

#### I. DEFINITION

Islamic commercial law is nothing more than, and also nothing less than, a code of conduct for the entrepreneur, either in trade or industry, designed to guide him in dealing justly with Allah and with his fellow man. The two basic principles, which are equal elements of the single law of tawhid, are that no man should claim for himself what is basically the creation of God and that no man should claim for himself what is the product of another man's effort and skills. The first principle governs property law. The second governs the law of contract.

Islamic banking is merely one form of the Islamic law of contract. The basic rule of Islamic contract law is that the parties must share both risk and profit in accordance with their contribution of value to the business objective. The basic goal of Islamic contract law is to promote even exchange, which in Arabic is called Suftadja. Deliberate failure to do so is an act of injustice, and failure adequately to specify the objects and terms of the contract creates a potential for injustice.

Both this sin and this occasion of sin are condemned additionally as a cause of conflict in the Muslim community. Such conflict is an offense against the brotherhood of men, which derives from the equality of all men in their relation to Allah. To violate Suftadja therefore is an offense against both man and God.

Two legal concepts determine the need for a banking system different from that customary in the Western world. Proper understanding of these concepts defines the nature of Islamic banking and provides guidance in how it should operate. These concepts are known in the Shari'a under the terms Riba and Mudarabah. The first is an evil, which is believed to lie at the heart of Western theories of money and banking, and the second is a technique to avoid such evils and accomplish good.

A. Riba

At the highest philosophical level, Riba is an attitude of taking as opposed to an attitude of giving, known as Infaq, in all one's relations, either with God or with one's fellow man. Since long before the supply-side economic philosopher, George Gilder, popularized the idea in the West, Muslims have always believed that economic growth comes from economic cooperation based on faith in the goodness of the material universe and in the essential goodness of men. They have always rejected the contention of Adam Smith that economic growth comes from the avarice inherent in the evilness of fallen man. If every man would mistrust his fellows and seek only to take from them, either from them as individuals or as a community, there would be no commerce, no prosperity, in fact no human society at all.

At the most specific level, Riba meant in pre-Islamic Arabia the practice whereby a lender increased and often doubled the amount of money owed, as a penalty for late payment of a debt due to him. This practice, known as Riba Nasia and translated as "interest on money debt," was based on a contract whereby the borrower agreed to repay both the principal of the loan and interest at a fixed time and additionally to pay a predetermined

amount of what Western lawyers would call "liquidated damages" for late payment. The damages presumably were to compensate the lender for losing his financial liquidity and therefore for losing opportunities to use the loaned money in other ventures or opportunities at his own time of choice. A second kind of Riba common in pre-Islamic Arabia was Riba al-Fadl, translated as "interest in barter," which refers to the exchange of commodities of the same kind in varying quantities, so that one party borrows a commodity and repays a larger amount of the same commodity as an equivalent of principal plus interest.

The root of Riba means both surplus and increase. This word thus fitted the credit institutions customary at the time of the Prophet Muhammad. It meant both the surplus received by the lender over the principal amount loaned and the increase in this surplus on the basis of a contingency occurring. The Kor'an, its interpretation by the Prophet, and the evidentiary practice of his Companions, clearly condemn both of these elements, whether used individually or in combination.

Later in the articulation of the Shari'a, the term Riba had only three definitional conditions: 1) a surplus in the amount owed over the principal amount of the loan; 2) predetermination of the amount of surplus to be paid; and 3) the designation of fixed times of payment to determine the amount of the surplus due.

The evil believed to be inherent in Riba, regardless of the amount of surplus, is the denial of equal exchange, Suftadja, in two ways. First, at the micro or individual level, Riba is a sure gain for the lender, because he is guaranteed a profit from the use of his money even if the borrower sustains a loss in its use. The lender thus imposes risk one-sidedly on the borrower. In effect, he is refusing to give in the form of sharing the risk of loss in the use of the money, and he is insisting on taking by demanding profit from this use even if there is none.

This evil of Riba is committed in any one-sided transaction, whether the one who commits it, the Sahukar, charges a predetermined "profit" from loaning capital, rents land in which he has invested no money or effort in improvements, or hoards goods to create a shortage and monopoly in order to receive a price higher than the value he has created through his own input of capital and labor and entrepreneurial expertise.

Certainly, the lender's use of his bargaining advantage over the supposedly helpless borrower may be an element of the injustice existing as a potential in Riba. And Islamic law tries to remove the potential for evil almost as much as the evil itself. But the real evil is believed to be the objective inequality of exchange, which is bad whether or not the contracting parties subjectively believe it is unfair.

In Islam, no man may contract himself into an unequal relationship, because God has created all men equal. Law is not what man wants it to be, but what Allah has declared to be just, and only Allah has the complete knowledge to know what justice is. No prohibition is clearer in the Kor'an nor more repeated nor more emphatic than the ban on Riba. In Islam, the political sovereign does not create the law. The law creates the sovereign, because the law is revealed by God through the Jewish Torah, the Christian Gospel, and the Islamic Kor'an, all three of which recognize the same God as the only true sovereign in the universe.

The second evil inherent in Riba lies at the center of discussion in Islamic economics. This is the social evil of Riba as the basis of modern, Western finance, which is said to: impede the productive circulation of wealth, concentrate wealth in a class of economic drones, create an imbalance between production and consumption, increase the cost of production at the

expense of the consumer, impose rigidity in costs and a bias toward shortrun planning in investment, encourage unproductive speculation, and trigger credit imbalances and inflation. The purposes of Islamic banking are to avoid such evils and promote economic growth and distributive justice in an Islamic society.

#### B. Muḍaraba

If the first legal concept basic to Islamic banking, Riba, expresses the disutilities (Mafasid) of Western financial mechanisms, the second, Muḍaraba, is an ancient, pre-Islamic institution selected only thirty years ago to provide an alternative mechanism suitable for maximizing the utilities (Maṣalih) of Islamic banking.

Muḍaraba (pl. Muḍarabat) is a limited partnership between one party who contributes capital for a business undertaking and another party who contributes entrepreneurial talent and labor. The first party is termed variously the silent partner, or financier, or capitalist, and the second party is termed the active partner, or working partner, or entrepreneur. The net income of the undertaking is divided between them by agreed ratio, reflecting the contribution each one makes to the success of the project. A highly capital intensive project would give a larger percentage of profit to the capitalist.

This particular arrangement was chosen as a basis for modern Islamic banking in part because it has always had the unanimous approval of the Fuqaha (sing. Faqih) or practitioners of the Shari'a, who specialize on classifying the fine points for application in courts (the process known as

Fiqh), and also of the Muftis, who are the philosophers of Islamic jurisprudence and advise the public generally on how individuals or the community can best pursue the general purposes either explicit or implicit in the revealed law of Islam.

There has always been some confusion of terminology and in recent times even some confusion of just what Muḍaraba is. The terms chosen depend on whether one views this legal arrangement from the view of the entrepreneur or the capitalist. The most common term, Muḍaraba, emphasizes the entrepreneurial element, because it derives from the word ḍarb, meaning beating or striking, as in forging ahead or striking out on a venture. This was selected by the great Muslim jurist, Imam Sarakhsi, because it conforms with the Kor'anic admonition to "strive on earth seeking the gift of God." The people of Medina, on the other hand, chose the more passive word, Muḡaraḍah, to describe this type of partnership. This is derived from the word, Qarḍ, which means "surrendering" and refers to the capitalist surrendering his rights over the capital that he has committed to the entrepreneur. A substantial minority of modern jurists thus use the term Qiraḍ rather than Muḍaraba.

The entrepreneur or working partner can be called Amil, or user of economic resources (Amwal). Usually, however, he is called ḍarib or al Muḍarib, but he can also be called Muḡariḍ. Similarly, the capitalist or silent partner can be called either Muḍarib or Muḡariḍ.

The meaning of Muḍaraba is clear, regardless of the terminology used. The great philosopher and jurist of the 13th century, Ibn Rushd, known in the West as Averroes, writes: "There is no difference of opinion among the Muslims about the legality of Qiraḍ. It was an institution in the pre-Islamic

period and Islam confirmed it. They all agree that its form is that a person gives to another person some capital that he uses in business. The user gets, according to the conditions, some specified proportion of the profit, i.e. any proportion they agree on, one third, one fourth, or even one half."

The American economist, Monzer Kahf, writes: "Qirad is defined as the act of injecting money assets in the production process through the cooperation of the entrepreneur who provides his entrepreneurial skill and the Muxariq who furnishes the funds. The reward of the Muxariq is called profishare and the reward of the entrepreneur is called profit. The crucial difference between profishare and interest on capital is that the former is a percent of the net income of the firm, whereas the latter is a fixed cost of production. ... The Muxariq has a direct, real, and long-run interest in the activity of the firm ... because its profits determine his profishare."

The following five conditions, in order of importance, have always been unanimously recognized as essential to the legality of a Mudaraba contract:

- 1) The share of each partner in the profits must be a percentage, not a fixed amount, i.e. the contract must not permit the injustice that can result from the financial technique of interest.

- 2) The Mudaraba contract is a limited partnership and thus differs from the full or unlimited partnership, known as Shirkat Inan. Each party to Mudaraba is protected in a different way from total liability. The capital contributor or financier (Muxariq) has limited liability in that losses in the joint venture beyond the amount of the capital invested are borne by the entrepreneur. Although the capitalist can be said to own equity in the project or enterprise, his other assets cannot be attached by any of the venture's

creditors. On the other hand, the assets of the working partner or entrepreneur (Muḍarib) cannot be attached by any of the venture's creditors until after the losses have been deducted from and exhausted the contributed capital.

This point is particularly important because it has been so misunderstood, particularly by those who have pioneered the use of Muḍaraba as the basic financial tool of Islamic banking. The principal observer and historian of Islamic economics in his capacity as its only analytical bibliographer, Dr. Muhammad Nejatullah Siddiqi of the King Abdul Aziz University in Saudi Arabia, points out that the distinction between Muḍaraba and Shirkah was not clarified even by Anwar Iqbal Qureshi, who in his pioneer book of 1948, Islam and the Theory of Interest, first proposed the reorganization of banking on the entirely new basis of profit sharing instead of interest. In fact, not until Dr. Muhammad Uzair, currently Consultant to the Investment Corporation of Pakistan, published his 21-page booklet, An Outline of Interestless Banking, in 1955 was Muḍaraba correctly defined as a potential tool in this new field of Islamic law and economics. His small work, the first devoted exclusively to the subject by a professional economist, contained the core of all subsequent proposals on the subject.

3) The entrepreneur or user of the capital must have complete discretion and freedom to use it in pursuit of the venture's goals.

4) All expenses for implementing the Muḍaraba contract or Qiraḍ are deductible before determining and distributing profits.

5) The capital must be in existence and not either a right or a contingency. Thus canceling a debt from the entrepreneur to the capitalist may not serve as the capitalist's contribution, nor may the capitalist contribute a debt owed to him by a third party. This would exclude a great many of the techniques

used in Western commercial law.

In addition, there are four other conditions, of which the first two have traditionally had minor dissenters and the last two are opposed by some leaders in the American Muslim community:

1) The undertaking may be either in trading or industry. A very small minority, led, however, by the greatest of all early Shari'a scholars, Imam Shafi'i, forbids Muḍarabah outside of strict buying and selling, simply because it was never used more broadly during the time of the Prophet. This restriction would totally invalidate the utility of Muḍarabah for the Islamic concept of investment banking.

2) The contributed capital or subject of Muḍarabah must be in cash, in order to assure that the capital is unequivocally determined so that the sharing of profits is not subject to later contention. This reflects a basic principle of Islamic contract law, but some scholars of the Malikite school have always questioned the necessity of this condition.

3) The duration of the Muḍarabah must not be predetermined or limited in time, as would be an interest-bearing loan.

4) Either party of the Muḍarabah may revoke the contract and terminate the partnership at any time after giving notice to the other party. This strengthens the Muḍaraba's consensual nature.

### C. Islamic Banking

Although theoreticians had written endless books and articles on what Islamic banking should be, a worldwide Muslim consensus on a best system of Islamic banking was first established during the deliberations at the Karachi Conference of Finance Ministers of the Islamic Countries in 1970. This produced two official followup studies, the 1972 Egyptian Study on the

Establishment of the Islamic Banking System, published as part of a series in Cairo on Economics and Islamic Doctrine, and the short, 21-page Kuwaiti Investment House Project.

The Egyptian study emphasized the introduction of Zakat through Islamic banking and other ambitious goals, whereas the Kuwaiti study focused on maximizing the security of all parties by proposing an elaborate scheme of precautionary reserves and profit distribution among all depositors and bank shareholders. Nevertheless, both studies and every official study thereafter agreed on one basic fundamental, namely, that Islamic banking can most successfully eliminate Riba through Muḍaraba. Two years later in 1974, the first Islamic bank in history, the well-endowed Islamic Development Bank, started operation to implement this concept by instituting a new form of Muḍaraba using the bank as a middleman.

Islamic banking consists of a two-tiered Muḍaraba, whereby the depositors enter into Muḍaraba with the bank, and the bank in turn enters into a Muḍaraba contract with the entrepreneurs. The Islamic bank is an "investment bank," also called a "merchant bank" in England, but one of a special kind. The "depositor" becomes a Muḡariḍ or capitalist and the "borrower", i.e. the person or firm obtaining funds, becomes the entrepreneur or working partner. The bank itself functions in both capacities. It is the working partner in a contract with the "depositors" and the silent partner in a contract with the "borrowers." The bank attracts deposits by promising to give a share of profits from immediate reinvestment, and it solicits or seeks to meet entrepreneurial demand for funds by promising to accept a share of the profits from the productive use of the funds in business.

By way of example, if the entrepreneur splits his profits with the

bank 50:50, and the bank splits its 50% profitshare with the depositor or supplier of capital at a 1:2 ratio, the bank would get one-sixth of the original enterprise profit and the depositor-investor one-third. If the enterprise profits are 20% of the invested capital for a five-year return on investment, the depositor would get a 7% return. This would tend to appreciate in real terms to match the rate of any inflation, because the money is deposited not as money in a bank account but as equity in a going, productive business. Since the real rate of interest in Western banking has always been about 4%, with anything above that merely reflecting expectations of inflation, the depositor in an Islamic bank, using the above example, would almost double his real return over what he could expect in interest from a Western-type commercial bank.

The three parties involved in the above two-tier Muḍaraba contract would set the ratios of their participation in accordance with supply and demand. This accords with the laws both of Shirkat and Muḍarabah. Plans for implementation in Pakistan, however, call for the Central Bank to set the profit-sharing ratios for both of these institutions, though the losses in Shirkat would continue to be borne in proportion to the parties' capital contributions. As discussed in Section II below on the Strategy and Tactics of Implementation and in Section III on the Problems and Prospects of Solution, the practical details of an Islamic system of money and banking will require an enormous amount of flexibility and creativity. The core concept, however, will remain the use of a two-tiered Muḍaraba contract and the elimination of Riba.

## II. STRATEGY AND TACTICS OF IMPLEMENTATION

Since Islamic banking is a branch of Islamic economics, and this, in turn, is a branch of the Shari'a or Islamic law, a major consideration in the implementation of Islamic banking is the guidance that can be obtained from the basic principles of law developed during the first century of Islam.

Western scholars have noted the nearly total lack of creativity among Islamic jurists in what Western jurists consider to be the core task of inducing principles from concrete rules and rulings. This has led Joseph Schacht, the West's most renowned student of Islamic law, to conclude that "the whole first century of Islam represented, from the juristic point of view, a void." From the Western perspective this is true, because the Prophet and his Companions clearly understood the Islamic principles and therefore had no need to deduce them from their own practice.

The creativity of Islamic law, and indeed of all indigenous intellectual thought of every kind in the Middle East up to the present day, is found in the reverse of the English legal process. The task of every jurist in Islam is not to induce from the particular to the general but rather to deduce from the general and eternal principles in the revealed Kor'an, the explanatory Hadith (oral communications of the Prophet), and the evidentiary Sunna (the usage or practice in the early Muslim community) to their particular applications in each jurist's own place and time. In fact, the task of all intellectual endeavor in Islam is to find and follow the path (Shari'a) from the holistic level of Din (religion, or the act and result of acknowledging, seeking, and serving God) to the lowest level of specific action.

Law in Islam has always functioned as a highly purposive institution to provide strategic guidance in changing both the human community and the human individual toward the Islamic ideal, leaving the tactics up to each man and each society of men. Law occupies the preeminent place in Islamic thought

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because God has revealed to man only His law through the prophets, not Himself and His nature. Since the Person of God is unknowable, except directly to the individual soul, theological speculation in Islam on His nature and attributes has always taken a distinct second place to the more profitable study of what is known and may be deduced about His commands. Islam has therefore always been a highly practical religion, based on the teaching that "to know is to do." For this reason also, religious Muslims are by nature activists and often revolutionary. Even the mystics in Islam, such as the sociologist and Iran's greatest modern intellectual, Ali Shari'ati, who met an "untimely death" in 1977 a few months before the riots started in Teh'ran, summarized his teachings with the simple phrase, "Life is conviction and struggle, and nothing more."

This activist nature of Islam, which has come to the fore repeatedly throughout the past 1400 years in the development of Islamic law, lends flexibility in interpretation. Like Western sociological jurisprudence, Islamic jurisprudence places very little value on legal precedent and very great value on individual judgement. Juristic reasoning is never final in Islam, because only the direct word of Allah in the Kor'an has finality. One generation of men is as competent to understand this word as any other.

This basic activism and creativity of Islam has often been submerged under the influence of Taqlid and the Muqallids (leaders of the reactionary response of Taqlid to any challenges to justice), who tried to attribute finality to one or other of the various schools of law and thereby to eliminate the very possibility of coping successfully with new challenges. But this recurring reactionary effort to ossify Islamic civilization as a "protection" against the distortion of change has been overwhelmed by the recurringly new movement of Tajdid, in which Islamic law and Islamic economics

intertwine. Modern Islamic law, like the original Islamic law of 7th century Medina, is a law not only of theory but of implementation. The only criterion of authority is the persuasiveness of any individual's arguments that his recommended application of the Kor'an is the most logical and effective way to implement the basic meaning of the Kor'an in everyday modern life.

This basic principle of legal legitimacy is augmented in the introduction of Islamic banking by an accompanying principle of tactical expediency. This is not the same as the principle of Hiyal, which is the use of legal fictions to obey the letter of the Shari'a and violate its spirit. The institution of Hiyal, which was a lifelong specialty of Joseph Schacht, has been the bane of Islam for more than 1,000 years and is the source of an entire body of "customary commercial law" which has both produced and resulted from a breakdown of law generally in the Muslim world.

The modern principle of tactical expediency is not an attempt to introduce or maintain a dichotomy and tension between legal theory and legal practice, but merely to acknowledge the need for compromise on the ideal as a means to achieve it. This is a matter of strategic and tactical judgement, but has obvious religious and political ramifications. Those officially charged by their governments to implement specific parts of the Islamic whole are careful to point out that to compromise on the ideal is unjustified in an Islamic society, but to reject compromise during the transition toward it might make this society impossible to attain.

Consensus is another important principle in the strategy and tactics of implementing Islamic banking. Consensus in the Muslim world has almost

mystic significance. It is the basis of political legitimacy in the requirement of rule through consultation (Shura) and it is the ultimate authority in legal interpretation (Ijma). Yet the leaders of the successful effort in 1970 to establish a consensus on what Islamic banking should be, recognized that even if all Muslim countries would share an identical conception of Islamic banking as a model with specific goals, no two countries share the same initial obstacles to implementation nor will any two experience the same success in overcoming them. In other words, the definition of Islamic banking in a practical sense will vary through space and time. The practical measures to implement Islamic banking, Islamic insurance, and Islamic fiscal policy through Zakat, have been and will be designed tactically to smooth the evolution of the financial and economic system during a period of transition toward the strategic goal.

The primary function of "implementing tactics" is to handle problems that arise during the phase of design and experimentation. A number of problems in Islamic banking have concerned both scholars and government officials, and an even greater number of courses of action have been recommended to handle them. Of greatest interest to American businessmen are the measures scheduled to be introduced in Pakistan in 1981. These represent the maximum that governmental technocrats consider feasible at present in instituting interest-free banking. These represent also less than the minimum that non-governmental ideologues consider necessary in order to avoid failure.

The battle in Pakistan between the technocrats and ideologues over Islamic banking is the first such confrontation in a practical context. This confrontation came to a head because in 1973 a new Constitution of Pakistan was passed, after 25-years of on-again-off-again stalling on carrying out the

Islamic policies for which the country was originally created. This new constitution provided that all laws shall be brought into conformity with the injunctions of Islam. Article 37 required the elimination of all interest in the financial and economic life of the nation.

The new president, Zia-al-Haq, on September 29, 1977, asked the Council of Islamic Ideology, perhaps the most prestigious thinktank in the Muslim world, to prepare a report designing goals and procedures to accomplish this task by the end of 1981. This Council produced a Report in February 1980, which presented a competent technical analysis of how interest could be phased out and alternative financial mechanisms phased in.

This was attacked in May 1980 by the influential Committee on Islamization. The Committee's 38-page Agenda for Islamic Economic Reform proposed that Islamic banking be pursued within an overall Islamic mission, summarized by the phrase "al Adl' wal-Ahsan" (justice with kindness), consisting of four purposes, 16 subordinate goals, and a great number of implementing objectives and courses of action, which were spelled out to provide a proposed context for all government action in Islamic renewal.

The Committee accepted, and in fact merely repeated, the technical measures recommended in the Report. But the Agenda insisted that these should be clearly labeled as interim measures designed as the first steps in a process aimed at the total abolition of capitalism. Invoking the name of the radically egalitarian Companion of the Prophet, Abu Dharr, the Agenda explained simply that the purpose of eliminating interest is to abolish exploitation, and the Agenda asserted that capitalism, by definition, is exploitative.

The Council then in June 1980 produced a revised 127-page Report of the Council of Islamic Ideology on the Elimination of Interest from the Economy, including a 21-page "Summary of Conclusions and Recommendations," which was published and distributed worldwide in the February 1981 (Rabi-al-Awwal 1401) issue of the Journal of the Muslim World League, headquartered in Mecca and New York. This Report failed totally to meet the arguments that its recommendations should be fitted into an overall hierarchy of Islamic purposes and goals and courses of action, whereby all the Islamic institutions essential for success would be linked. The authors and sponsors of the Report obviously considered that their mandate was only to work out the technical aspects of phasing in an Islamic system of money and banking. This had never been done before, and it necessarily assumed an underlying agenda of society-wide Islamic renewal.

The actual implementation of Muḍaraba as the basis for an Islamic financial system in Pakistan therefore will be closely watched throughout the Muslim world. Hopes for the introduction of Islamic economic institutions in Iran were rapidly dashed as the Muḡallids, i.e. the leaders of Taqlid, clashed with the Muḡaddids, i.e. leaders of the Tajdid movement of positive and creative Islamic renewal. In Pakistan, one more opportunity, under very difficult conditions, is being presented for Tajdid under a political leadership of evolutionary reform rather than radical revolution. Some fear, and some hope, that failure of the one might lead to the other.

### III. PROBLEMS AND PROSPECTS FOR SOLUTION

The major problems foreseen by both scholars and practicing bankers in implementing Islamic banking can be grouped into the following eight categories: 1) the integrity of the Islamic banking system in the face of fraud, ignorance, and "black market interest"; 2) the compatibility of specialized statutory laws with Islamic banking, especially the laws of corporations, commerce, real estate, trust, and agency; 3) non-investment transactions, such as savings and current deposits, as well as consumer and short-term loans; 4) competitiveness of the system with legal domestic alternatives, such as the stock market and hedging in land and commodities, and with foreign financial markets; 5) security of banking when all its institutions become, in effect, investment banks; 6) liquidity and credit management for both the banks and the central government; 7) public sector banking; and 8) foreign transactions and international cooperation.

#### A. Fraud and Ignorance

The most serious problem, in the view of those responsible for implementing Islamic banking in Pakistan, has rarely been mentioned in the scholarly literature. This is the problem of fraudulent accounting by the entrepreneurs, perhaps even in collusion with some banks, in order to avoid sharing profits in a Mudaraba arrangement with the bank. This is usually referred to as the problem of the "moral climate" and then passed over.

The Report of the Council of Islamic Ideology on the Elimination of Interest in Pakistan faced this issue head-on and advocated both a reform of the income tax laws to support Mudaraba banking and the temporary use of a number of alternatives to either Mudaraba or interest until the practice

or at least the effects of fraud and corruption are reduced to manageable size.

"A thorough-going reform of the Income-Tax system is a sine qua non for the success of an interest-free banking system. This is because of the fact that under the new system, the income of the bank would crucially depend upon the profits of the business firms which receive financial assistance from them. If the existing system of Income Tax remains as it is, the business firms would continue the malpractice of concealing their profits and maintaining multiple sets of accounts. ... Most of the enterprises either do not maintain accounts or do not maintain them properly or keep different sets of accounts for different purposes. ... Some of the typical manipulations in this regard are: over-valuation of opening inventory and under-valuation of closing inventory; overvaluation of assets to inflate depreciation in order to reduce or eliminate profit; excessive remuneration charged by directors who are in most cases relatives of the entrepreneurs. ... The auditors are most concerned with the legality rather than the propriety and veracity of the expenditure shown."

The Report devoted ten pages to describe, unfortunately in highly abstract terms, three recommended, four permissible, and two prohibited devices to substitute for Muḍaraba and interest in cases where either the possibility of fraud or the simple absence of accounting capabilities would warrant it. The Report concludes that "once a substantial improvement in the standards of honesty in the society is achieved and literacy becomes widespread, then the alternative methods will be automatically rendered superfluous and the financial institutions will be able to operate purely on the basis of PLS (profit/loss sharing, i.e. Muḍaraba) and Qard-i-Hasan

(loans without interest). Prior to the completion of an extensive campaign and effort to upgrade accounting capabilities, the only sector required to shift immediately, i.e. prior to July 1, 1981, to Mudaraba financing is heavy construction (page 29).

The seven permitted techniques of financing are not clearly explained in the literature, nor are they broken down into categories of "recommended," "permissible," and "prohibited." Every American businessman active in an Islamizing country, i.e. one attempting to transform itself from a simple Muslim country into an Islamic one, should at least know what alternatives to interest exist and what their rank order of public policy preference is, both generally and sector by sector. Ranging in a spectrum from good to bad, the alternatives in Pakistan are:

1. Good and Recommended

- a. Investment Auctioning

Commercial banks in this option would form a consortium with long-term investment banks and prepare a business plan for a specific business undertaking, such as manufacturing air-conditioners. The consortium would call for bids from firms to manage and carry out the business and to purchase the necessary plant and equipment from the consortium. The consortium would set a minimum price for the plant and equipment in order to guarantee a good profit to the consortium from its purchase of the plant and equipment and subsequent sale to the successful bidder. The managerial entrepreneur would pay for the plant and equipment in installments over a fixed period out of operating income, but with absolute liability for the total purchase price. The bidders would pay the consortium's price for the plant and equipment only if the bidders expect earnings both to pay for the plant and

equipment and to produce an adequate profit. This bidding process is designed to enhance the probability that the business will be profitable and therefore that it will efficiently allocate resources in the economy.

There is some question whether in such investment auctioning the sale of equipment prior to its purchase or even existence is legal under the Shari'a, because the sale of a future product may give rise to dispute later over its conformity to expectations. The Report states that on this matter it has "accepted Imam Abu Yusuf's opinion," who was elevated by the Abbasid Caliph, Harun al Rashid, to be Islam's first Chief Qadi or judge with universal jurisdiction.

This alternative to interest, of course, could also be combined with joint ownership so the consortium would earn both from the sale of plant and equipment and from a share in the operating profits.

b. Long-term Leasing or "finance leasing"

The entrepreneur selects a piece of equipment, such as a truck, from a manufacturer; the bank purchases the truck and leases it to the entrepreneur. The entrepreneur has exclusive use of it and pays enough rent to pay for the truck and an additional profit to the bank before the truck is depreciated to zero. The banks might form leasing companies to manage such transactions. Under Shari'a law, the cost of insuring the truck would have to be paid by its owner, the bank or the bank's leasing company.

c. Short-term Hire-Purchase

Banks would finance the purchase of machinery and equipment or even consumer durables, such as copiers and typewriters, under joint ownership. The entrepreneur would partially purchase and partially rent the equipment. He would repay the principal out of his share of the income

and then on a preset date purchase the bank's interest in the equipment at its then market value, which would depend on depreciation and market conditions. This contract for renting the equipment is contingent upon its purchase at a future date and hence is questionable under the Shari'a because it might cause future disputes. The Report recommends this contractual technique only if it contains the normal conditions governed by custom and tacitly approved by the Fuqaha.

A variant of this technique is Bai Salam, which is normally used in agriculture to permit purchase of products before they are grown. The Report recommends this for short-term financing of trucks taxis, or other equipment (page 29), as well as for agricultural produce, but warns (page 44) that the Kor'an and Hadiths lay down strict conditions for Bai Salam in order to avoid any misuse of price fixation in advance as an exploitative device. For this reason, the government may have to create "an independent agency" to monitor this alternative to interest in banking.

Perhaps significantly, the Report notes that it "has accepted the conditional contract of hire-purchase on the ground of necessity." The best recent book on Islamic law as a system of thought, Philosophy of Islamic Law and the Orientalists, by Muhammad Musleh-ud-Din, Lahore, Pakistan, recommends "necessity" (Darura, or Darura wa Hajat, i.e. Necessity and Need) as a formal technique of interpretation, in addition to the standard techniques of rationalist equity (Istihsan), which was pioneered in the second century of Islam by Imam Abu Hanifa in Bagdad and underlies the Hanifite school of law, and pragmatic positivism (Istiṣlah), which was pioneered by Malik ibn Anas in Medina and underlies the Malikite school. All three of these approaches

(Istihsan), Istiṣlah, and Darura, which latter Muslehuddin claims really is the basis of the first two) are often considered to be forms of Ijtihad, which with the Kor'an, the Sunna, and Ijma, make up the four sources or roots (Usul) of law in Islam. Both Istihsan and Istiṣlah, however, are designed really to curtail subjective personal opinion (Ra'y) and thereby to maintain the purity of revealed truth, whereas the doctrine of "necessity" (Darura) has no inherent limits, other than those already present in the practice of Istihsan and Istiṣlah. Necessity or Darura is invoked to accommodate desired "exceptions" to the Shari'a, which should not be necessary if the Shari'a is recognized as a general systems theory or system of cybernetics, which would accommodate in one way or another all moral alternatives. One could easily regard appeal to necessity therefore either as unnecessary or as dangerous from the Islamic point of view in determining the morality of tactics. The danger is that the doctrine of "necessity" not only is unnecessary but is difficult to distinguish from simple expediency, which is precisely what the entire effort of Islamic renewal is designed to overcome.

## 2. Acceptable but Dangerous

### a. Bai Muajjal

This is defined as sale with the price of the item payable on a deferred basis, either in lump sum or in installments. In buying producer commodities, such as fertilizer or bulk cloth, this could substitute for the present techniques of discounting a bill (which is clearly a form of interest) or advancing cash at interest. In Bai Muajjal, the bank finances the entrepreneur's purchase of an item from domestic or foreign producers by buying the item on its own account and selling it to the firm at a price, to be settled in advance, which includes a mark-up over the cost price for

a reasonable profit to the bank. Payment from the entrepreneur would be due at an agreed later date or in installments. Although the Shari'a would require that the bank possess the item first and then sell it to the entrepreneur in simple trade, the Report cites the Fatwa Alangiri, in the Kitab al Bai, as authority to permit the supplier of the item merely to hold it on account for the purchasing entrepreneur.

The Report warns that, "although this mode of financing is understood to be permissible under the Shari'a, it would not be advisable to use it widely or indiscriminately in view of the danger attached to it of opening a back-door for dealing on the basis of interest. Safeguards would therefore need to be devised so as to restrict its use only to inescapable cases." After June 1980, short-term agricultural loans were permitted only interest-free with government aid or on the basis of Bai Muajjal or Bai Salam (page 29).

b. Financing on the Basis of Normal Rate of Return

This is a very simple device in theory whereby a specialized public agency would determine the normal rate of return in a particular business sector and the bank would advance funds upon the understanding that it would receive back the principal plus a sum to reflect the standard rate of profit for the firm and for the bank. Any profit above this amount would be paid voluntarily to the bank, and any lower rate would have to be proven to the specialized agency.

The Report warns that "if the actual profit turns out to be more than the normal rate of return, it would be unrealistic in view of the existing moral standards in society to expect that this difference would

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be surrendered by the entrepreneur voluntarily to the bank. ... Therefore there is a strong possibility that its widespread use may in practice degenerate into pure interest. ... Its use should be restricted to financing only those small entrepreneurs who cannot be expected to maintain proper accounts or get them audited."

c. Time Multiple Counter-Loans

This appears to be a simple legal trick in the nature of Hiyal, whereby the borrower and the bank each make loans to each other so that the bank earns the equivalent of interest. As an example, the entrepreneur borrows 100 Riyals from a bank for 3 months and simultaneously loans back 10 Riyals for 3 years. The bank's earnings on the 10 Riyals in profitable investments would substitute for interest payments by the entrepreneur. The Report clearly labels this as definitely not "a permanent alternative system," but suitable in the interim "for providing personal loans to people of small means." Americans should avoid this kind, or any other kind, of evasive tactic.

d. Special Loans Facility

As an emergency safety net to cover cases in which neither Muḍaraba nor any of the above substitutes for interest are adequate, the Report recommends that the Government subsidize banks out of a Special Loans Facility to give interest-free loans. The loan principal should come from deposits, such as current checking accounts, on which the bank does not pay a return to the depositor. The Report cautions that "in order to minimize the impact of such loaning on the profitability of the financial institutions, it should be insured that it remains restricted to a scale considered absolutely necessary." As of July 1, 1980, in the first of three phases in

the shift to an interest-free system, all personal loans were to be made from this facility (page 29) as were agricultural loans to subsistence farmers.

3. Bad and Condemned

a. Service Charge

This technique, which is extensively used or recommended in the Middle East, is rejected primarily because it is impossible to determine what the true costs of servicing a financial transaction are, with the possible exception of very large ones of prime customers. The banks consequently would set a fixed rate, which would be impossible to distinguish from interest.

The Report rejected this substitute for interest also because:

1) thus limiting the return to a service charge might mean providing capital resources at a cost below that required in a capital scarce economy for allocative efficiency; 2) the banks would suffer because the depositors would get no return; 3) the banks would then have insufficient funds for business needs; 4) the central bank would be forced to increase the supply of money and create inflation; 5) the central bank would have no mechanism by which to regulate credit flow, as it would in Muḍaraba banking by regulating profit-sharing ratios both between the bank and its customers and among banks; and 6) last but not least, the normally rich borrowers would benefit at the expense of the normally relatively poor depositors, which would continue the bias inherent in the Western system of money and banking using interest whereby the rich get richer at the expense of everyone else.

b. Indexation of Bank Deposits and Advances

Indexing the nominal value of money to the rising cost of living is used in Brazil, Argentina, and some other countries to protect depositors' money in banks and the bank's money loaned to entrepreneurs from

loss of value through inflation. Public policy arguments are advanced in Pakistan against indexing loans or advances of funds from banking as a substitute for high interest rates, because often in inflation the profits in industry and agriculture lag behind those in commerce, which puts a greater burden on the borrowers in the lagging sectors to pay back indexed loans.

More important, however, from the perspective of Shari'a law, is the express prohibition against treating money differently from the commodities it represents. And commodities borrowed must be repaid without interest, i.e. they must be repaid in the identical quantity of the same commodity, even if the price of the commodity has changed in the meantime.

This Shari'a principle is designed to guarantee that all financial gain will come only from the input of entrepreneurship, labor, and capital, and not from the mere passage of time or from essentially unproductive speculation. And if profit from commodity exchange should not include gains beyond the true value added, certainly a fortiori profit should not be allowed from speculation in the price of money, since money is not even a commodity but a means of exchange and nothing more.

As discussed below in the section on Zakat, Shari'a law is designed to articulate the command that every man should become wealthy, but only from the value he contributes to society. Wealth should come only from work so that it will remain an incentive for productivity. Any other basis of man's economic life not only will impede the aggregate growth of wealth in society but will lead to injustice in its distribution. Once this very basic principle, laid down in the first century of Islam, is fully understood,

the intricacies of Islamic banking, Islamic insurance, and Islamic fiscal policy, as branches of Islamic law, can be understood almost without the need to study them. As in any general systems theory, so in the Shari'a, once the basic rationales are understood, as they were by the early Muslims, the structure and applications come automatically. Western students of the Shari'a should first learn the principles, though they might consider these to be religion not law, and then they might better understand both the actual and the potential role of Islamic law and economics in the modern Muslim world.

#### B. Black Market Interest

The integrity of the Islamic interest-free banking system, particularly during a period of transition from the Western interest-laden system, must be protected not only from fraud and ignorance in the operation of the system, but also from illegal efforts to by-pass it altogether.

The principal danger, as Abu Saud warned in Mecca in 1976 at the First International Conference on Islamic Economics, is that evasion of the Islamic system would create a situation far worse than now exists under the Western system. If a black market developed in lending money for a price, the banks might not be able to attract deposits, which would mean that the major credit system in society would fail in its job of intermediation between the savers and users of capital. The government would be forced to print money and this would cause inflation. Moreover, the de facto banking system, operating illegally, would be unregulated and would develop wealth-concentrating features far worse than those the proponents of Islamic banking are now trying to eliminate.

Still worse than black-market evasion, however, might be a "gray-market" evasion through the de facto growth of customary law into a double system of banking formally disapproved but informally accepted by governmental authorities. The old tensions between Shari'a theory and administrative practice would return with a vengeance. Undoubtedly, however, so would the movement of Tajdid, which arose periodically in the past 1400 years to enforce Islamic law not only by letter but also in spirit and therefore in fact. The most successful such movements were the century-long Almoravid movement of Tajdid in Spain and Northwest Africa from about 1050 to 1146; the government-led movement of Sulayman I almost 450 years later in the first century of the Ottoman Empire; the Wahhabis of 18th and 19th century Arabia, and the Fulanis of 19th century Nigeria. None of these, however, had such world-wide support as the present movement nor the backing of so many Muslim intellectuals trained in the technical operations of money and banking.

The concern about evasion of the Islamic system stems in part from ignorance of how it might operate. Western scholars have long cited the Islamic prohibition against interest as proof that the Shari'a itself is inherently defective, since a prosperous, interest-free economy from the Western perspective simply cannot exist. Thus in the most prestigious Western study on Islamic law, Law in the Middle East, edited by Majid Khadduri and Herbert Liebesny, Professor Vesey Fitzgerald writes: "It is beyond doubt that in spite of the abiding strength of devout Muslim sentiment against usury and gambling, these prohibitions have been consistently evaded throughout the history of Islam. Otherwise, commerce and finance, particularly

the financing of agriculture, would have been brought to a standstill."

Like almost all Western scholars until the last year or so, Vesey-Fitzgerald dismisses without any consideration the very possibility of an alternative to the Western system of money and banking. And until twenty years ago, so did almost all Muslims as well.

The success of current efforts to institute an Islamic system of money and banking in Pakistan, and therefore the impact of past scholarly efforts to design an effective system, cannot yet be forecast. The answer lies in the details and flexibility of the system as much as it does in the exogenous economic and political environment of the countries that may embark upon the experiment.

#### C. Compatibility of Related Laws

The real task in Islamic banking is to assure that related institutions, such as industrial corporations, insurance companies, underwriters, and trade associations, operate in support of Islamic banking. The intent of those who manage these institutions will be the decisive factor. The legal incompatibilities between Islamic banking and these other institutions however, must be eliminated to facilitate effective support. The major areas of legal reform are in commercial law, corporation law, tax law, and banking law. Examples are:

##### 1. Commercial Law

Every area of commercial law must be redesigned, including sales, mortgage, hire, lease, agency, trust and defalcation, and securities and exchange; and many special regimes of law must be fundamentally rewritten, such as, in Pakistan, the Chartered Accountants Ordinance. Perhaps the most critical single area is the financing of working capital requirements for

day to day operations of both industrial and trading corporations. The major tool of such finance is the bill of exchange.

An example of the ingenuity required is a technique recommended by the Report of the Council of Islamic Ideology on the Elimination of Interest on the strength of the Imdad al-Fatawa. Using this precedent for replacing the bill of exchange with an equally effective technique, the Report recommends that the entrepreneur as drawer of the bill enter into two contracts with the bank, the first one appointing the bank as its agent to collect the amount from the third-party drawee of the bill on the due date, and the second providing for a loan in an amount equal to the value of the bill. The loan would be free of interest, but the bank would receive a commission in advance for collecting the bill.

## 2. Corporation Law

Another major area of legal revision is underwriting, i.e. the provision of capital during the period between the founding of a company and the successful sale of its stock publically. The Report gives examples of relevant changes that must be made in the corporation law of Pakistan. The Shari'a forbids the standard Pakistani practice of "bridge financing," whereby the underwriters require interest for their funding of a company in its initial existence before it has sold its stock. The Shari'a, however, does permit "firm commitment" financing, whereby the underwriters take part of the equity at the inception of the new company. Unfortunately, the Companies Act forbids "firm commitment" underwriting, which is compatible with the Shari'a, and approves only "bridge financing," which is not (pages 35 & 55).

Similarly, the provisions for debenture financing, which pays a fixed amount in the nature of interest, must be replaced with a new form of

corporate security, to be called the Participation Term Certificate (PTC), which would be secured, like a debenture, by a mortgage on the fixed assets of the company.

### 3. Tax Law

Tax laws function not merely to raise money for the government but also to provide incentives and disincentives in support of public policy. The possibilities are unlimited, but can be illustrated in their potential by Abu Saud's suggestion that owners of urban land should not be permitted to profit from the sale of their land beyond the value of the improvements they have put in. This would discourage sceptics from putting their money in land for capital speculation rather than in Islamic banks. Rather than resort to such a draconian measure, one could foresee an Islamic government merely levying a graduated capital gains tax on profits above the amount of the purchase price plus improvements.

### 4. Banking Law

The entire banking law must be redesigned, because many countries, following the example of industrial countries during the depression of the 1930's, have made it illegal for commercial banks to take the risks that would be involved in Muḍaraba or investment banking.

Less major redesigning would be necessary to prevent fraudulent access of wealthy individuals to concessional banking through credit societies, as recommended in the Report on page 64, as well as new legislation to provide deterrent penalties and punishments against accounting fraud of every kind in Muḍaraba arrangements.

And finally, even the most minor details must be rewritten in administrative law, for example, to enforce the Central Bank's requirement

that commercial banks keep certain cash and liquidity reserves. The penal interest rate of 4% on any shortfall each day might be converted as recommended in the Report, page 68, into a fine graduated to match the amount of the default.

#### D. Non-Investment Transactions

Perhaps the single most debated issue in Islamic banking, at least among the scholars, is how to handle deposits and loans that do not fit the Muḍaraba purpose of investment finance.

##### 1. Savings and Current Deposits

One of the pioneers of interest-free banking, Muhammad Uzair, Consultant to the Investment Corporation of Pakistan, recommended at the Mecca conference on Islamic economics in 1976 that there be three distinct kinds of accounts: a) the "investment accounts," which are designed to earn money; b) the "savings accounts," which are designed to hold money securely; and c) the "current accounts," which are merely checking accounts designed to provide transactional convenience. The investment accounts would be the core of Muḍaraba banking, because they would share the full risks as well as profits of investment banking. The current accounts would share in neither profits nor losses. And the "savings accounts" would be invested conservatively in government securities with small prospects of large gains and even less of any losses.

One might envision also investment of such savings accounts in publically favored sectors, if they have governmentally guaranteed profits, as does the utility industry in Saudi Arabia. The Saudi government has always guaranteed its electricity producers a 15% net return on investment, because

it wants to promote private enterprise but also regards electricity as a public service. This return is not necessarily achieved, but subsidies are given to assure that the profit will not fall much below that amount, and the consumer price of electricity is regulated to match the subsidies. A number of other measures have been suggested to enhance the security element of savings deposits. Some of these are indicated below in the next two sub-sections on competitiveness and security.

The Report of the Council of Islamic Ideology on the Elimination of Interest in Pakistan recommends on pages 48-49 that both savings deposits and investment deposits (particularly time or term) earn a variable return reflecting a new technical concept known as "daily product of the amounts." This will be perhaps the most fundamental accounting concept in Pakistani banking. The variable return would represent the total earnings of a bank, less administrative expenses, taxes, appropriations for reserves, and costs of interbank transactions. "The calculation of the profit and loss would be made on the basis of daily product of the amounts. These daily products would be assigned different weights so as to ensure an edge for capital and reserves and longer-term deposits. The weights would be prescribed by the State (Central) Bank. ... Profits and losses would be computed and distributed at six month intervals ... and the period of fixed deposits would be six months and its multiples. ... Holders of current account deposits would share neither in the profit nor loss." As in the United States, savings withdrawn before the distribution day would earn nothing for that period.

## 2. Short-Term Advances

The literature on Islamic banking focuses unusual attention on the simple technical issue of operating a Muqaraba system for short-term

credit, i.e. 30 to 90 days. Since profit is usually determined in enterprises on an annual basis, it would be a great burden to require entrepreneurial partners (borrowers) to calculate the profit from the use of funds for shorter periods. The usual suggestion is that the return on the bank's short-term advance can be figured by using the average annual rate of profit. Credit evaluations, which would be more critical when the return is a net profit rather than a fixed return before profit like interest, could set limits on borrowing by linking it to the average deposit balance of the borrower during the previous year.

Very short-term advances of less than 30 days, such as occur from overdraft privileges, would be financed by a simple service charge based on the amount of credit advanced. This is considered to be not really a loan, but merely a convenient service offered to good customers. As discussed below in the next section on competitiveness, such services no doubt soon would be provided free of charge by the more successful banks.

### 3. Consumer Loans

This is a major issue area. The two critical issues in consumer loans are excess credit expansion and sociological/moral desirability of such loans. There seems to be a strong consensus that loans for personal needs should be interest-free. But since the demand for personal loans under an interest system is restrained by the cost element, there must be devices in an interest-free system to restrain the demand for such loans.

Although the Agenda, which critiques the Report of the Council in Pakistan, stressed that economic growth should not come from funneling funds into capital accumulation at the expense of immediate consumption, all specialists in Islamic banking agree that the opposite could be much worse.

Unrestrained demand for personal loans would divert funds from productive enterprise and toward unproductive consumption, which would inflate prices and trigger a long chain of economic dislocations.

A most innovative suggestion has been advanced by Dr. Muhammad Uzair, who recommended at the 1976 Islamic Economics conference in Mecca, Saudi Arabia, that commercial banks finance the supply side of consumer goods rather than the consumption side. The banks would finance the outlets and wholesalers that supply the goods by using techniques of hire purchase and installment finance. The banks would share the profit with the agencies selling the consumer goods. Uzair does not recommend Mudaraba for this approach to consumer finance, but it might be designed to work effectively in this consumer sector also. The residual demand for consumer loans should be small enough to handle through the interest-free "residual fund" carried in the banks' interest-free current account deposits.

And direct consumer loans would be restricted, of course, also by normal loan evaluations in order to assure that the borrowers could repay the principal. Abuse of the interest-free system by borrowing funds that do not produce new income and new goods for consumption would be dangerous but it also could be monitored, especially in modernizing Islamic societies where computerized credit management would be routine.

Much more serious is the moral desirability of consumer loans. This issue may be difficult for the consumption and credit addicts of Western civilization to understand, but it is hardly an issue any longer among theorists and practitioners of Islamic banking. Uzair terms it simply the issue of "living within one's means." He questions whether the principal customers for such loans, the middle class, should raise their standard of

living in advance of higher income expected in the future. Here the issue does not involve macro-economic policy or even the evil of gambling. The theorists recommend simply that the temptations for individuals to become credit-junkies should be eliminated before credit becomes a new God. In a mature Islamic state, the needy would not require loans, because Zakat is designed for their needs and the economy would be sufficiently productive and egalitarian so that the demand on the Zakat Fund should be easily manageable

The Report states that the normal types of consumer loans should be made under the Special Loans Facility described above on pages 38-39, and such "normal" loans should rapidly become "abnormal." The Report's special section on consumer loans concludes with the recommendation that: "Under the new system, banks may generally not provide any personal loans. Meritorious students, however, may be provided loans to finance their studies without interest. Consumer durables (such as autos) may be financed under 'Bai Muajjal' or hire-purchase arrangements on a restricted scale. ... Personal loans in calamity-stricken areas may be provided by the Government from the Federal Zakat Fund." The Report recommends on page 50, in fact, that the very term "loan" should be abolished as a hangover from the outdated system of interest-laden banking.

#### E. Competitiveness

Even if abuse and illegal evasion of the Islamic banking system can be kept within tolerable limits, and even if all the laws of related institutions are redesigned to support Islamic banking and the internal technicalities of operating the system have had the bugs worked out, still the question remains whether the Islamic banking system can compete effectively with alternative means of investing and obtaining funds.

The 1972 Egyptian Study on the Establishment of the Islamic Banking System, which was commissioned by the finance ministers of all the Islamic countries in 1970 as the first official study on Islamic banking, gave considerable emphasis to this issue of competitiveness. In contrast, the Kuwait Investment House Fund study, commissioned at the same time, stressed the security of the system. In fact, the two issues are related.

Since current accounts, which do not bear interest, are the most profitable ones in Western banking, the Egyptian Study recommended that great effort be given to attracting such money. The recommended incentives included: 1) exemption from service charge; 2) profit-sharing based on average monthly deposits; and 3) liberal banking services, such as accepting bills of exchange without charge. Even savings account depositors would get special deals, such as acceptance of letters of credit, checking rights, and overdraft facilities. This all seems familiar to modern Western bankers who have emerged from the era of overregulation and been driven to the most ingenious incentives to beat the competition.

Perhaps the most ingenious and innovative recommendation appeared in the Agenda, which critiqued the Council's Report as not being sufficiently Islamic. On pages 22-23, the Agenda recommended indexing interest rates on both deposits and loans, which the Report vigorously condemned as contrary to the Shari'a, as described above on pages 39-40. The Agenda recommended this strictly as a tactic to lower the interest rate in those banks still charging interest and thereby to make Islamic banks appear more profitable. This also would discourage borrowing in general to obtain investment funds and would encourage investment through Islamic banks. Although this elimination of fixed interest has been recommended for years by occasional Muslim scholars,

the Agenda viewed it strictly as a step in the elimination of interest altogether. This tactic is one of six objectives under the goal of "promote allocational efficiency," which is one of six goals under the Agenda's fourth purpose, "economic growth."

The Council in the Report rejected this tactic not only because it is contrary to the Shari'a and because it is nothing more than a tactic with no substance, but especially because the Council decided not to introduce Islamic banking through a model bank or even through the gradual conversion of one group of banks after another to an interest-free system. The Council concluded that the competitiveness of Islamic banking requires all banks simultaneously to convert to interest-free operations, though the conversion in all banks would proceed through stages, and certain alternatives to both interest and Muḍaraba might survive for many, many years.

The problem of competitiveness of Islamic banking at the macro level is distinct from the problem of competitiveness at the level of the individual bank. The Report recommends measures both to enhance the competitiveness of the individual bank within the Islamic system and to restrain such competitiveness where necessary. An example of the former is the recommendation that the Central Bank regulate profit ratios, as explained below under sub-section G on liquidity and credit management, by using maximum and minimum ratios, not a single one, for all customers, and situations. This maintains a balance between uniformity of regulation and the diversity necessary for the individual bank management to compete through superior judgement and innovation.

This regulation of profit ratios is also designed, as the Report phrased it on page 19, to "reduce unhealthy competition among the financial institutions." The Report recommended, for example, on page 51, that the

nationalized commercial banks should all have uniform rates of return, which would be achieved by pooling profits among all the banks. Thereby the principle of Muḍaraba would be maintained even though an element of guarantee would exist to protect the less competitive banks, particularly during the period of transition when learning on the job can be dangerous. The difficult legal problem involved in creating a functional guarantee when the nature of Muḍaraba requires risk sharing is touched on in the next section on security.

The major problem of competitiveness is not a temporary one of transition but the permanent one of how the Islamic system will function once it is fully on line. How can the Muḍaraba system of investment banking, for example, compete with: 1) stock brokers, whose commissions and margins may be hard to beat; 2) foreign banks, money markets, and stock exchanges abroad; and 3) land and commodity speculation? Part of the answer at the domestic level is governmental regulation. But at the broader international level, which is the more important one, the answer certainly is not protectionism in banking (through either exclusionary measures or subsidies) any more than it is in trade, even though the "infant" Islamic banking system may have a claim to such in the interim. If Islamic banking can grow together with the overall Islamic environment, and in conjunction with other Islamic institutions, competition will pose no problem.

The "bottom line," however, in any discussion of competitiveness, from the Islamic point of view, is the performance of Islamic banking in furthering the ultimate goals of Tajdid and Tawhid. Western economists generally cannot conceive of any measure that extends beyond the material world, whereas Muslims generally cannot conceive of any measure that does not.

The leading Muslim specialist on the sub-discipline of Islamic utility analysis, the American, Monzer Kahf, has developed this aspect of Islamic economics for more than a decade. In his paper at the First International Conference on Islamic Economics held at Mecca under the sponsorship of the King Abdul Aziz University in 1976, Dr. Kahf notes that: "The theory, ... developed in the West after the rise of capitalism, is an offspring of a duality, namely, 'economic rationalism' and 'utilitarianism'. Economic rationalism interprets human behavior as being founded on a 'rigorous calculation directed with foresight and caution toward economic success' (Max Weber). Economic success is strictly defined as 'making money out of man'. The acquisition of wealth, whether in terms of money or in terms of commodities is the ultimate goal in life and at the same time the yardstick of economic success. ... The utility to be maximized is that of a 'homo-economicus' whose sole goal is to achieve the highest level of economic acquisition. ... One aspect of the dialectical materialism of Marx is that it is a mere 'restatement' of this doctrine in a historical perspective."

In contrast to economic success as the sole yardstick for judging the competitiveness of Islamic banking, Kahf has developed a widely acclaimed yardstick of Islamic utilities. Rather than reject the technique of utility maximization, he merely redefines the goals toward which action is to be most efficiently and effectively directed. His first postulate is that "the time horizon of the Islamic individual is extended to include the hereafter

Applied to both the individual and the human community, this turns production and profit, as Muhammad al-Mubarak puts it, from ends into means. Islamic banking, like Islamic insurance and Zakat-based fiscal policy and

every other institution of Islamic economics, must be judged, as they would in the West, by their utility in promoting economic growth. As explained below at length under the purposes of Zakat, this in turn is merely a means to promote distributive justice aimed at human prosperity in the widest sense (Falah), and this prosperity itself is merely a means to Islam, which is submission to God.

The question for the Muslim is not so much whether Islamic banking can compete with Western techniques of finance in serving the Weberian bottom line, but whether the Western system of interest-based finance can compete with an Islamic system designed to promote equally both Falah (material prosperity) and Salah (prosperity in the life of prayer). This message of the Muslim's "bottom line", against which absolutely everything must be judged, has been reiterated five times every day in the Adhan (call to prayer) in every Muslim city and village for more than a thousand years.

#### F. Security

The sixth problem addressed in the literature and now in the initial practice of Islamic banking is security both of the individual depositor and of the entire Islamic banking system.

The exposure of the individual depositor to the risks of investment banking in the Muḍaraba system and what to do about it has been discussed at great length in the literature. Muhammad Siddiqi says that in principle each depositor should bear the loss attributable to his own account in order to conform to the rules of Muḍaraba, but he notes that there are practical devices not in the nature of Hiyal to absolve the individual depositor from losses. One technique is to use a kind of internal insurance by covering the losses in one account with the profits from all the others. In case of a

net loss on all accounts, this principle of insurance could be applied on an interbank basis.

This principle of insurance can also be applied to the "borrowers" as well as to the "depositors." Thus "bad debts," i.e. losses in the partnership between the bank and the entrepreneur, could be covered through a formal Cooperative Insurance Fund, to which each "borrower," i.e. entrepreneur or active partner in the Muḍaraba, would contribute a sum of money in proportion to the capital he receives from the bank.

The Kuwaiti Investment House Project in 1972, which first addressed in detail the micro level of security in Islamic banking, proposed an elaborate scheme of precautionary reserves and profit distribution to all shareholders of the bank as well as to all its depositors.

The macro level of security, i.e. the security of the entire system of Islamic banking, was given relatively more emphasis in both the Report and the Agenda, which emerged from the process of introducing Islamic banking in Pakistan. The Report proposes that the Treasury or Ministry of Finance protect the financial stability of Islamic banking by acting as a "non-obligatory guardian" of all deposits.

At present, the Government of Pakistan gives an absolute guarantee of deposits through the central bank (State Bank). This is illegal under Shari'a law for two reasons. First, the Muḍaraba concept, and the Shari'a generally, provide that whoever wishes to earn a profit from a business undertaking should also accept any losses. This principle can be maintained, according to the Report, by turning the legal guarantee into a moral obligation. Second, any guarantee by a party to a business transaction against losses by the other party is in the nature of Riba. The prohibition against Riba or

interest can be maintained if the guarantee is given by a disinterested third party, because such a party could qualify as Wali al-Amr or guardian, and such guardianship is legal in the Shari'a. For this purpose, the Treasury would be sufficiently dissociated from the Muḍaraba contract of an Islamic bank to qualify as a guardian, whereas the Central Bank would clearly be a party of interest. Thus the Report recommends, on pages 51 and 91, that for a two-year transition period only, the Pakistani treasury undertake the moral but unenforceable obligation to replace all losses in Muḍaraba banking.

The American, Professor Mahmud Abu Saud, seems to recommend in his chapter, "Money, Interest, and Qirad," in the Ahmad book of 1980, entitled Studies in Islamic Economics, that such guarantees should be a permanent part of Islamic banking, because he contends that if depositors must take the risk of loss in Islamic banking they might as well deal in Muḍaraba directly and eliminate the profit of the bank.

This question of minimizing losses and maximizing profits for the depositors, as well as for the shareholders of the banks, is addressed by two proposals in the 38-page Agenda for Islamic Economic Reform. The first proposal, on pages 24-25, is to create investment companies with sufficient knowhow to minimize the risk and thereby promote profit-sharing by banks, which would invest their deposits in these companies. The banks and investment companies would earn a commission for their services, and the depositors would bear the risk of loss as well as the benefit of profits.

The Agenda's second proposal, on pages 25-26, calls for the government to maintain interest-bearing securities at low rates in order to assist both banks and individuals balance high-risk profit-sharing with low-risk interest-bearing instruments. Riba, of course, has nothing to do with whether the

interest rate is high or low. The willingness of the Agenda to accept the continuation of interest derives from its fifth objective under the goal of promoting allocational efficiency. This is totally to socialize the economy so that government planning and ownership rather than profits will coordinate the saving and investment function in society. Islamizing the banking system by eliminating interest does not appear to be a real aim of the Agenda authors as much as merely a tactic on the road to Marxist egalitarianism through total state control of economic production, distribution, and consumption.

The most important security measure for Islamic banking and for the private-enterprise principles of Islamic social justice, which undergird it, is to coordinate the introduction of Islamic banking with the introduction of Zakat and all the other institutions of a modern Islamic society. The Islamic banking system would be crushed if it were forced to bear alone the burden of Islamizing a Muslim society. Merely eliminating interest in the economy would cause more harm than good, because it would abort the entire effort to build an Islamic economy.

Without the Islamic pillars of society, and without the spirit of giving or Infaq that underlies every one of them, no Islamic institution could be implemented without a high level of governmental coercion. The failure of governmental coercion to implement what is implementable only through moral power requires still more coercion. And every proponent of Islamic renewal (Tajdid), as distinct from Islamic reaction (Taqlid), firmly believes that no society based on governmental coercion, whether in the form of socialism or capitalism, can be Islamic.

## G. Liquidity and Credit Management

One of the principal elements of any concept of Islamic banking is the Central Bank, which is responsible for orchestrating a coherent system of money and banking. The Central Bank in any Islamic country has four tasks: 1) Create money and regulate liquidity; 2) Provide and regulate commercial credit in order to optimize economic growth at both the macro and micro levels necessary for a just society; 3) Provide concessional credit as an instrument of distributive justice; and 4) Provide banking services for the government's own operations.

### 1. Monetary Control

Monetary control through the creation of money and the management of its supply is considered to be one of the most important moral obligations of Islam, because it shares with fiscal responsibility the task of combating inflation. The Report states, on page 83, "Inflation really results in defrauding the people of the value of their earnings and savings. In the context of the following verse of the Holy Quran: 'So give full measure and weight without defrauding people in their belongings and do not corrupt the world after its reform. This is better for you if you are believers' (VII:85), it is the bounden duty of an Islamic state to ensure reasonable stability in the value of money which is a measure of value for other goods and services as well as a store of value."

The government would have several tools for monetary control in an Islamic system. It controls money directly by printing money and maintaining gold reserves. And it controls the money supply indirectly through such measures as open market operations and credit management. The principal tool in Western countries for macro money management is the sale of government interest-bearing

securities, with high interest rates designed to sop up liquidity and dampen inflation. It injects money into the economy by buying these securities back. This tool of central banking, like all the others, can be redesigned to operate effectively within an interest-free system. In an Islamic society, the Central Bank would sell its own variable dividend securities, which would share the profits from the entire banking system deriving from the Central Bank's own Mudaraba operations with regional banks. The Report states, on page 80-81, that open market operations are not yet developed in Pakistan, nor are they in any other Muslim countries, but this development is merely one of the tasks that lie ahead.

In his survey of the literature, Siddiqi lists a number of suggested techniques to control liquidity in an Islamic system. At the macro level, the major one is offering refinance facilities, which control the amount of credit that regional and local banks can create, contracting it during inflation and selectively controlling its availability to implement national priorities among economic sectors. The Report states, on pages 51-52, that the Central Bank's refinance facility would be used mainly to handle temporary liquidity shortages and would be accomplished on a basis of profit/loss sharing (i.e. Mudaraba) using the "daily products of the amounts," as would all interbank transactions.

At the micro level of the individual bank, the theorists have recommended that the Central Bank might enforce national credit standards, such as the credit needs of the firm requesting capital, the nature of the security offered, whether a short term advance or investment is needed to protect a long-term one, the monthly average of the applicant's current account balance, and the social priority of the entrepreneur's enterprise.

## 2. Commercial Credit

Much the best discussion of credit control is found in the Report of the Council of Islamic Ideology on the Elimination of Interest in Pakistan. A major objective of the Report is to maintain credit creation by private commercial banks as a means to promote allocative efficiency, in contrast to the recommendation by the Agenda that all private credit creation be abolished as the only road to economic rationality. The Report discusses four distinct kinds of credit operations, though it does not identify them as such:

a. General, long range. The instruments of such macro credit control, namely, cash and liquidity reserves and maximum loan limits, would be the same as before. The only difference is that the cash reserves held by the Central Bank (5% of each bank's total deposits) and the maximum loan limits would be enforced by fines rather than penal interest, and the liquidity reserves (35% of deposits) would be held by each bank in its vaults as cash, gold, and non-interest-bearing securities rather than interest-bearing ones.

b. General, rapid reaction. The more time-sensitive or rapid-reaction instrument of general credit control has been the rate of interest charged by the Central Bank on loans to commercial banks (through cash advances, rediscounting bills of exchange, etc.). The rate is raised to prevent the demand for credit from rising so fast or far that it would cause inflation or an adverse balance of international payments, or else the rate is lowered to stimulate the economy.

This federal interest or discount rate could be replaced by the equally effective method of raising or lowering the federal share of the profits earned from funds provided by the Central Bank (pages 72-73).

In this arrangement, the Central Bank would replace the private depositor as a supplier of funds in the two-tier Mudaraba arrangement. The difference between this and a regular private transaction is that the federal partner (the Central Bank) in this Mudaraba contract could set the profit-sharing ratios both between itself and the bank and between the bank and the entrepreneur.

c. Selective. Specific, policy-oriented credit controls, such as those targeted either to aid socio-economically preferred sectors or to prevent speculation in particular commodities, are now orchestrated by raising and lowering the percent of the loan (margin) that must be maintained by the bank. This aim can be equally well achieved by raising or lowering the permissible ratios of profit-sharing between the entrepreneur and the bank (page 70).

d. Fine-tuned. Tailored controls fine-tuned to fit the individual bank, which are imposed in the United States by the Comptroller of the Currency, have been imposed through maximum and minimum interest rates on deposits and loans, but can equally well be imposed through maximum and minimum profit-sharing ratios (page 71). The spread between the maximum and minimum allows the bank to reward credit-worthy partners (borrowers) and retain competitiveness with other banks. The losses, of course, would be shared between the banks and their entrepreneurial partners in proportion to their respective capital contributions (page 77).

### 3. Concessional Credit

The inequalities of wealth and income both vertically between rich and poor and horizontally between geographic regions in most Muslim countries would require considerable reliance on concessional credit, i.e. at cheaper

rates, by the Central Bank. In Pakistan, such preferred banking sectors have been the first to switch from interest to Mudaraba banking. The first was the House Building Finance Corporation (page 79), and the others to follow are agriculture, small business, small industry, and cooperatives.

The techniques of converting from interest to Mudaraba in concessional finance are just as simple as in regular commercial credit. For example, when the Central Bank's loans to domestic semi-governmental development banks, such as the Pakistan Industrial Credit and Investment Corporation (PICIC), are converted to Mudaraba, the concessional loan rate would be converted to a concessional profit-sharing ratio (page 56).

This would apply also to cooperative credit institutions, which are now given umbrella credit at the federal level by the Federal Bank for Cooperatives. The federal loan rate to provincial banks is 2% below the Bank Rate or interest rate on loans from one bank to another. The provincial or regional cooperative banks make loans to the local credit societies at the Bank Rate, and the credit societies make loans to their members at just 2% above the Bank Rate. In a Mudaraba system, the Central Bank might take 10% of the profit from the Federal Bank for Cooperatives; the Federal Bank might take 20% of the profit earned by the provincial banks using federal funds; and the provincial banks might take 30% from the cooperative credit societies (page 63).

Significantly, the Report states that "refinance under the Export Finance Scheme may be provided as interest-free loan" (page 79), which goes beyond concessional finance into clear subsidy.

## H. Public Sector Banking

Three types of domestic governmental transactions would be affected by a shift to an interest-free economy: 1) governmental fund raising; 2) governmental advances; and 3) public sector organizations.

### 1. Fund-raising

The shift to an interest-free economy would have a major impact on the ways the government obtains funds, other than by taxes, namely, through securities, notes or bills, and savings certificates. The problem is put clearly by the Report: "The marketable government securities are taken up largely by institutional investors. After the abolition of interest, fresh market loans carrying a fixed rate of return will no longer be issued by the Federal and Provincial governments. It would be difficult to raise resources on a profit/loss basis because most of the items of Government expenditure are not amenable to equity financing. The borrowing requirements of the Government therefore will have to be met largely from the State Bank on an interest-free basis" (pages 36-87).

Similarly, treasury bills issued by the Federal Government to the Central Bank would have to become interest-free. Savings certificates would continue to pay interest until their due date, but no new ones would be issued.

The government would continue to borrow from commercial banks to buy essential agricultural and other commodities, and this borrowing would all have to be done interest-free. The commercial banks would levy a service charge to cover actual administrative costs only, and in addition they would be able to obtain interest-free loans from the Central Bank as "counter-finance" to provide the loan funds for the government purchasing departments (page 87).

Governmental fund-raising through pension (Provident) funds from individual contributions would replace interest with a bonus equivalent to the rate of profit declared by the National Investment (Unit) Trust (pages 26 and 89).

## 2. Advances

Governmental loans would also have to be converted to interest-free advances, whereby the recipients would repay only the principal amount. The major kinds of loans that would have to be converted in most countries are: 1) to regional and local governmental bodies; 2) Taccavi loans for agricultural development and disaster aid; and 3) loans to government employees.

## 3. Public Sector Organizations

Most governments operate both financial institutions and public sector corporations. The financial institutions in Pakistan, such as the Agricultural Development Bank, the Small Business Finance Corporation, and the new Equity Participation Fund, would all use Muḍaraba just as any "private" commercial bank. Like any private bank, they also could use the recommended alternatives to Muḍaraba, i.e. investment auctioning, long-term leasing, and short-term hire-purchase, as well as Bai Muajjal, in accordance with the suitability of each alternative to the particular sector or requirement involved (pages 58-61).

The public sector corporations could no longer borrow as before from commercial banks, because they might unduly burden the Islamic banking system. In the past in Pakistan, according to the Report, such corporations have often operated inefficiently and yet have obtained financing from private banks by governmental fiat. In order to protect depositors in Islamic banks from this burden, the Report recommends, on page 22, that the financing of

unsound public enterprises should either be subsidized by the government or handled by a separate government agency.

#### I. Foreign Transactions and International Cooperation

The last of the major problems foreseen by both scholars and practitioners of Islamic banking is the interface with foreign financial institutions that use interest. The general principle acknowledged by everyone who has written in the field of Islamic banking is that interest must be abolished in domestic transactions but must be continued in international transactions whenever the foreign party insists on it. The long-range hope is that eventually Islamic banking will be successful enough so that foreign financial and commercial institutions will be willing to adopt Islamic practices when dealing with Islamic countries, and someday even in their own societies.

Again in the field of foreign transactions, much the best treatment is in the Report of the Council of Islamic Ideology on the Elimination of Interest. Although it does not so label them, the Report distinguishes the following four kinds of banking using foreign funds:

##### 1. "Private" Commercial Banking

The Report recommends that foreign branches of Pakistani banks continue using interest in both deposits and loans, and that foreign currency deposits in Pakistani banks and all transactions with foreign banks should likewise. In order to avoid merging interest and non-interest banking, the Report urges that both foreign branches of Pakistani banks and the foreign currency deposits of domestic banks be handled by a separate corporation, which would not accept local deposits. This, however, is contrary to the Shari'a and thus should be viewed as an interim measure until such time as alternative

arrangements can be developed without disrupting the financial system.

2. Governmental Concessional Banking: Long-Term or "Investment"

This category consists of specialized institutions with large foreign governmental ownership. There is only one such institution in Pakistan, the Pakistan Industrial Credit and Investment Corporation (PICIC), which has 35% foreign ownership of its stock, mostly by financial institutions of industrialized countries, including a 3.5% interest by the World Bank (International Finance Corporation). This category of foreign banking has problems involving stock, debentures, loans, and borrowings. The Report recommends that stock and loans accept the new Islamic system and that debentures and borrowings maintain the option to operate under the old system of interest.

a. Stock. The PICIC foreign shareholders must either assent to shifting to Mudaraba or divest themselves of their shares.

b. Loans. The loans made by the PICIC must convert to Mudaraba or use any of the three good and recommended alternatives (investment auctioning, leasing, and hire purchase) or the best one of the four acceptable but dangerous ones, namely, Bai Muajjal.

c. Debentures. The interest operations of the PICIC consist of debentures, loans and borrowings. The debentures issued by or purchased by the PICIC may be converted to Participation Term Certificates, though where a party refuses to convert he may continue his interest-bearing debentures until maturity.

d. Borrowings. Borrowings would continue to be with interest where necessary, and would be guaranteed by the Government of Pakistan, so "it is hoped that on account of this guarantee, foreign lenders would not insist

that relending transactions pertaining to foreign loans should continue to be on the basis of interest." This hope applies to a large AID interest-bearing concessional loan, to loans of the World Bank and Asian Development Bank, to the net use of Special Drawing Rights of the International Monetary Fund, and to PL-480 Counterpart Funds (page 82).

### 3. Governmental Concessional Banking: Short-Term or "Commercial"

Local development banks that make or guarantee loans for working capital requirements, i.e. short-term or commercial loans, must convert to Mudaraba and its alternatives just as any commercial bank. There is only one such bank in Pakistan, the Industrial Development Bank of Pakistan, with concessional loans from international governmental sources (e.g. the World Bank and the Asian Development Bank). It must follow the same rules as the PICIC, i.e. it may borrow at interest from foreign governmental sources, but it must make "loans" on the basis of Mudaraba and alternatives (page 57).

### 4. Governmental Non-Concessional Banking, Investment and Commercial

All non-concessional banking, such as the National Development Finance Corporation (NDFC), whether for long-term development or short-term operations, will operate just as regular commercial banking. Interest will be permitted on borrowing from foreign sources, but not on loans to domestic recipients (pages 57-58). Requirements for long-term loans in this type of banking would be met by Mudaraba, and for short-term, including letters of credit, by either Mudaraba or Bai Muajjal.

### 5. Intergovernmental Borrowing

In addition to institutional borrowing, in Pakistan the federal government borrows directly from foreign sources and also loans directly to

provincial governments. Both its borrowing and intergovernmental loans will continue to be interest-bearing to the extent that they come from foreign sources. But the government intends to set an example of interest-free loans from other Muslim countries and thereby to develop a new basis for intergovernmental economic cooperation worldwide.

PART III

Z A K A T

I. DEFINITION

A. Zakat

Zakat (also spelled zakaat and zakah) is a compulsory levy by the government of an Islamic State to guarantee that those in society with an abundance of wealth will share their abundance with the needy. Zakat generally is not considered to be a tax in support of the government, but rather a minimum amount of charity owed by every individual of means to other individuals. The government's role is to enforce an objective standard of "abundance" in the collection of the Zakat funds and of "need" in their disbursement.

B. Sadaqat and Infaq

Zakat is sometimes distinguished from Sadaqat (also spelled Sadakat), which refers to voluntary or supererogatory charity above the minimum in Zakat. The government may serve as a middleman also for this charity, as the Saudi government did until 1974. Often, however, Sadaqat is used in reference only to Zakat or even to both compulsory and voluntary charity. Confusion can be avoided by using a modifier, whereby either Zakat il Fitr or Sadaqat il Fitr is obligatory and Sadaqat it-Tatu'wa is voluntary.

The proper word to encompass both Zakat and Sadaqat is Infaq, which is the act of giving in a general sense. In the Kor'an, there are 29 references to Zakat, 7 to Sadaqat, and 52 to Infaq. These and also the 78 further references in the major collections of Hadith (Traditions) are trans-

lated in the Zaman book, which was published in 1981 and is listed in the bibliography below.

### C. History

The history of Zakat goes back to the beginning of Islam. A similar custom as a cultural rather than religious institution was universal in the Arabian tribes of pre-Islamic times (the Jahiliyya or so-called Times of Ignorance). Zakat was a powerful institution during the first forty years of Islam, i.e. the period of rule by the Prophet Muhammad from 622 to 632 A.D. and the period of rule (known as Khilafat ir Rashidun) by the four Right-Minded caliphs, Abu Bakr, Umar, Uthman, and Ali from 632 to 661 in Medina. After the Caliphate moved out of Arabia at the end of the Rashidun Caliphate, only one caliph, Umar bin Abdul Aziz, the 8th Umayyad caliph, from 717-720, ever again maintained the institution of Zakat, though governmentally-assisted Sadaqat survived off and on until the present.

### D. Taxes

In addition to Zakat, there always were levies of a more secular nature intended to support governmental functions. These therefore can be classified as taxes in the Western sense. During the Khilafat ir Rashidun, these additional levies were lumped together in the Zakat Fund managed by the finance ministry (Bait il Mal), and were not earmarked for specific beneficiaries. The Shari'a-designated Zakat beneficiaries thus often received more than the Zakat payers (il Muzaki) contributed.

These additional taxes, which were not formally recognized in the Shari'a until two centuries later, consisted of the emergency or "calamity" tax, Nawa'ib; the land tax, Kharaj; the "poll tax" on non-Muslims in lieu of military duty, known as Jizyah or Jijia; and the tithe on agricultural

produce, Ushr. This Ushr tax remained part of Zakat after the others were distinguished from it. For a short time there were also what amounted to raiding taxes, the Ga'nima on moveable spoils of war against unbelievers and the Fa'ee on immovable spoils of war.

In later centuries, a bewildering assortment of taxes, most of them condemned by the 'Ulama as un-Islamic or anti-Shari'a, became common. Such extra-Shari'a taxes as the Dara'eb (pl. Dariba) under the Abbasid Caliphate in the 10th and 11th centuries and the Ma'ks (pl. Mukus) under the Mamluks in the 14th and 15th centuries were so numerous and oppressive they produced economic decadence and politico-religious revolt.

#### E. Present Status

Although the Shari'a permits almost any kind of tax, except on liquor, gambling, and prostitution, the only levies now considered to be purely Islamic are the Zakat, including Ushr, which has very specific beneficiaries and detailed rules for collection, and the two nominal levies collected by religious leaders during the two major religious festivals, namely, the Id al Fitr at the end of Ramadan, and the Id al Adha at the end of the Hajj. Nowhere in the world today is Zakat an active Islamic institution. During 1981, Zakat is scheduled to be reintroduced in Pakistan for the first time in more than 1000 years, and many other Muslim countries intend to follow this example. Only when a Muslim country has revived all the traditional religious institutions, including Zakat, may it be called Islamic.

#### II. BENEFICIARIES

Zakat has eight permissible categories of beneficiaries. Unless a particular objective can be fitted within one or more of these categories, funding for it must be obtained from another source than Zakat. Extreme

interpretations can extend these categories to include infrastructural projects for economic development and even military research and development.

The properly Islamic interpretation must depend on: 1) the general purposes of Zakat within the overall concept of Tawhid, as explained below under Section V; 2) the general purpose and methods of the Shari'a, which govern Zakat; 3) both the general approach and specific rules of the Madhhab or school of law (pl. Madhabib) accepted in the given country; and 4) the status of administrative law (Siyasa) in the given country as an expression of accepted legislative and/or executive discretion in applying and/or augmenting the Shari'a.

The eight universally accepted categories of Zakat beneficiaries are:

A. Fugara (sing. Faqir), i.e. the poor. This refers to the chronically destitute or the temporarily unemployed who have no income at all. Among the issues of interpretation developed by both Muftis and economists in modern Fiqh and Ikhtilaf (see glossary) is whether this category can justify the use of Zakat as an unemployment tax designed to enable workers to bargain for good wages in obtaining a new job.

B. Masakin, i.e. the needy or indigent. This refers to those who have the bare necessities of life but less than the Nisab level of minimal comfort. They would be the "working poor" in Western terms. A major issue of interpretation, discussed in Section V below under economic allocative justice, is whether Zakat funds may be used to buy stock in profitable businesses, including the Masakin's own place of employment, in order to provide a steady income from dividends in addition to wages.

Dead issues, which still concern some 'Ulama, involve, for example, the contention of Ash-Shafii that the first two categories of Zakat are

identical, so that the destitute (Fuqara) get 2/8th instead of 1/8th of the total Zakat collected, or the old view that Fuqara refers only to Muslims and Masakin only to non-Muslims.

C. Amilin-alaiha, i.e. the collectors or administrators of the Zakat system. Upper limits vary by commentator from 5% to 75%. The major issue is how much overhead can the Zakat Fund absorb without threatening the very purpose of Zakat. The Saudis abandoned governmental administration of Sadaqat in 1974 in part because the management costs threatened to exceed the total Sadaqat funds.

D. Muallat il Qulub, i.e. Those Whose Hearts Are to Be Inclined. This refers to recent converts who suffer as a result of conversion, as well as those who persecute recent converts and can be influenced favorably by "foreign aid." The Hanafi and Maliki schools believe this purpose of Zakat lapsed when it became inactive only a few years after the Prophet's death.

E. Fir Rikaab, i.e. Ransoming of Slaves. This was later used to ransom political prisoners. By extension it can be used to provide initial capital for skilled laborers to become entrepreneurs or even to purchase stock for poorly paid workers.

F. Al-Gharemin, i.e. the Debtor. This is designed for the normally prosperous who are temporarily bankrupt through no fault of their own, for the poor creditors of deceased debtors, and especially for those who were overly charitable in Sadaqat.

G. Fii Sabil Allah, i.e. In the Cause of Allah. This is a comprehensive category designed to advance the overall cause of Islam and of the Muslim peoples generally, either by missionary work, religious teaching, scholarly research, or military defense. Some commentators have restricted this category to Jihad in the specific sense of military warfare.

H. Wabnus Sabil, i.e. Wayfarers. This includes travelers temporarily without money and even political and religious refugees.

Since Zakat has these specific beneficiaries, it cannot serve as a substitute for other taxes. For example, Zakat is not a social security tax in the American sense, because it is both too narrow to cover all welfare needs and too broad to be restricted to such an objective since four of its eight categories go far beyond social security.

### III. COLLECTION

The rules on the collection of Zakat determine the rates of Zakat; the exemption levels; and the kinds of wealth that are zakatable, i.e. subject to Zakat; and personal status of foreigners.

#### A. Rates

Very generally, Zakat is an assessment on three types of wealth: property that increases in value through commerce, especially inventories in trade, mining, and agriculture; non-liquid savings; and liquid or invisible savings, i.e. money. The rate of Zakat varies in order to reflect:

1. The degree of necessity of the product or zakatable item for bare subsistence. Thus the Zakat levy is neither a real estate nor property tax as known in America. Zakat excludes residential houses, clothes, household goods, food for consumption, books, and livestock used for meat and for transportation. Zakat is levied only on wealth that grows, i.e. is not used for subsistence but to produce more wealth.

2. The level of comfort deemed reasonable in any given society. Thus each kind of zakatable wealth is exempt up to a minimum comfort level, termed Nisab. Everyone should freely enjoy his material wealth above the subsistence level but should feel constraints above the level where his accumulation of wealth might cause social conflict by appearing to be at the expense of other people's subsistence.

3. The amount of human inputs required to produce the final value. The greater the amount of human input, either in labor or capital, the lower

the rate of Zakat. The greater the input of natural resources or free value (e.g. sun and rain) provided by Allah, the greater the rate of Zakat. This graduated rate of assessment is designed to maximize human effort in transforming natural resources into wealth by rewarding both capital and labor intensivity, which are regarded equally as keys to producing economic growth and material prosperity.

#### B. Zakatable Kinds of Wealth and Exemption Levels

The five types of zakatable wealth and the exemption levels recognized in the Shari'a are as follows, listed in order of increasing human input as a percent of total value, and thus in order of decreasing rate of assessment:

1. Natural resources (mines and treasure troves). The production of minerals and products given to all men by Allah is taxed at the highest rate, i.e. 20% of the value possessed on the date of Zakat assessment. There is no exemption or Nisab level, because mineral wealth, other than salt as a food, is least necessary for either minimum comfort or subsistence.

2. Agricultural products from unirrigated land. Crops that grow unaided with the rain provided by Allah are subject to a special Zakat tax, Ushr, of 10% payable by the cultivator of the land out of the total produce before deductions for expenses. The Nisab or exemption level is 1,000 Kgs (one ton) of produce above that needed for the cultivator's subsistence.

3. Agricultural products from irrigated land. Crops that are produced with major inputs of human labor and/or capital ("stored labor") in the form of irrigation are subjected to an Ushr tax of only 5%, or half of the Ushr, which means tithe. The Nisab for all Ushr is the same.

4. Commercial goods and industrial products. These are produced

generally only with high inputs of capital and labor and therefore are taxed at only 2½%. Since gold and silver in Islamic economics are viewed only as a medium of exchange rather than as mineral wealth, they are taxed at the same 2½% levied on the commercial goods for which they substitute. Paper money and other "invisibles" are taxed the same way. The Nisab is 3 ounces of gold and 21 ounces of silver or its equivalent in currency, commercial goods, or industrial products.

Jewelry traditionally is exempt from Zakat, but a growing minority of jurists include it because precious stones are now readily negotiable in commercial markets. Gold and silver ornaments for women are zakatable by traditional majority opinion, but the Malik, Shaf'ii, and Hanafi schools apply a higher Nisab than the 3:21 gold:silver formula to reflect a looser definition of hoarding.

5. Agricultural animals used for commercial purposes in producing salable products, e.g. milk and wool, or used for breeding and thereby to produce animals for sale, but not including animals used for meat and subsistence requirements. The rate varies in this category between 1 and 2½%, depending on the intensity of care required for each type of animal. The Nisab or permissible non-taxable herd limits are 40 sheep or goats, 30 cows and buffalo, and 5 camels. Horses were not originally zakatable until Islam extended to regions where they were kept as commercial property rather than for their owner's own use.

#### C. Personal Status of Foreigners

The traditional Islamic international law applies to Zakat, which means that in any given territory the laws of a person's community govern. Islamic law is personal not territorial, so foreigners carry their own law

around with them. Particularly since Zakat is a religious duty and one of the five pillars of Islam, non-Muslims are not subject to the Zakat levy. In Pakistan, this exemption is reinforced by the high priority on avoiding any adverse impact on foreign trade and investment from the measures to implement Islamic economics, especially the measures to implement Islamic banking, Islamic insurance, and Islamic fiscal policy (Zakat).

Although the strong consensus is that the Shari'a generally, and Zakat specifically, apply to juridical persons, i.e. corporations, those companies with foreign majority ownership are exempt at least up to the extent of such ownership. The early Muslim practice, innovated by the second Caliph, Umar, of levying only fractional taxes on foreigners, in order to stimulate foreign trade, provides some basis for exempting all companies with substantial foreign direct investment.

#### IV. IMPLEMENTATION

The reintroduction of Islamic economic institutions as the ruling norms in society requires not only the growth of an entire new discipline of theoretical Islamic Economics, but a new body of implementing experience in moving through the transition period from a Muslim to an Islamic society. This new body of practice includes experience in legal interpretation, administrative adaptation, and Islamic accounting.

##### A. Legal Interpretation

The five categories of wealth and the three principles underlying them (degree of necessity, level of comfort, and human productive input) are applied to modern norms of wealth through the traditional Shari'a methods of Qiyas or analogy, with resort as needed to broader Ijtihad, Ijma, Istihsan, Istishlah, and even Kalam (see glossary).

### B. Administrative Adaptation

The Shari'a law on Zakat as determined by the above principles of Shari'a interpretation must be distinguished from administrative law (Siyasa) designed with the pragmatic aim of avoiding problems while evolving through the transition phase toward an Islamic society.

For example, in the 1979 Zakat and Ushr Order in Pakistan, the Zakat payer is called Sahib il Nisab, i.e. the men who has wealth above the exemption level, but in reality he is whoever in accordance with the regulations of the 1979 Order has Zakat collected from him. This excludes, for example, shares and debentures not paying dividends or interest, agricultural produce, commercial inventory (stock-in-trade), mineral production, gold and silver, and checking accounts.

These items, which are zakatable under majority Shari'a opinion, are to be designated Second Schedule or Amwal il Batinah. This is a term normally used to refer to non-apparent wealth, but in Pakistani administrative law it now will mean merely Sadaqat or voluntary disbursement. Whatever is zakatable will be designated as First Schedule and termed Amwal iz-Zahirah, which normally means apparent wealth. These significant departures from the Shari'a are no less important than those in the introduction of Islamic banking, but are deemed essential, at least in Pakistan, for a transitional period in order to avoid political opposition and even financial chaos. Failure to make progress toward an Islamic State would have caused even more problems.

### C. Islamic Accounting

Islamic accounting as a separate Islamic institution critical to

the success of the Tajdid movement was first developed at the University of Cairo and at the Al Ain University in the United Arab Emirates in 1980. As a sub-discipline within the new discipline of Islamic Economics, Islamic accounting is essential to the success of muḍaraba banking, muḍaraba insurance, and Zakat. Two examples of its role in the implementation of Zakat are as follows:

1. Rationalization

One aim of Islamic accounting in Zakat is to assure that the goals of justice are applied during its design and implementation. By way of illustration, the internal integrity of Zakat requires that:

a. Share capital and inventory not both be zakatable simultaneously, because the value of inventory is included in the value of the shares. Inventory would be zakatable only if share capital, for whatever reason, is not zakatable. Otherwise the implementation of Zakat would conflict with its high priority goal of stimulating, not impeding, incentives for rapid economic growth.

b. Life insurance policies be zakatable when the policy matures, is surrendered, or pays a survival benefit, but only after loans against the policy are first deducted. Otherwise, policyholders would seek Zakat benefits rather than use their own credit available in insurance policies, and the insurance industry itself would decline as an augmenting alternative to Zakat.

2. Prioritization

Another aim of Islamic accounting in Zakat is to assure that all other taxes are subordinate to Zakat and to the top priority given throughout Islamic fiscal policy to the spiritual nature of Zakat, as explained in Section V below. Courses of action toward this objective are to follow the

majority recommendations that:

a. Multiple assessment should be forbidden on the same base during any one stipulated period of Zakat assessment. In other words, there should be no double taxation, and Zakat should have the first claim. For example, zakated wealth should be excluded from net wealth for purposes of any secular Wealth Tax, as well as for purposes of Sadaqat, i.e. voluntarily self-assessed wealth. Personal and corporate income taxes should be permitted only if they are levied on current income, regardless of how much is saved, and not on net savings over a specific zakatable period, in order to avoid using the same basis for both taxes. One-time levies, such as capital gains taxes and inheritance and estate taxes, should be permitted for the same reason.

b. Zakat payments should be deductible against income tax.

c. If Zakat is levied on personal income, which is a very hot issue in scholarly circles throughout the Islamic world, such Zakat payments should be credited against income tax.

d. If salary and wage income, as distinct from wealth, is zakatable above the Nisab level, the amount should be determined, at least during an introductory transition period, by the weighted sum of an individual's wage income and the value of his other-money income throughout the zakatable period. The fear is that unscrupulous people with high salaries or other high income can avoid Zakat by spending all their income (in actuality or on paper) and thereby retain a low zakatable net worth (i.e. assets less liabilities at the end of the Zakat period), while sincere low-salaried or fixed-income Muslims would pay Zakat out of religious duty. The American expert, Monzer Kahf, recommends a compromise by weighting the two elements, and others recommend including the sum of the income, as well as tax relief for those entirely on

fixed income.

e. No additional levies should be imposed on personal or collective incomes if the assessee's income falls below the Nisab stipulated in Zakat. For this purpose, partnership income should be figured for each partner separately, which would provide a larger aggregate tax exemption.

f. The calculation of expense items in all taxes must be in accordance with the Shari'a requirements for Zakat, which have been spelled out in detail in the Shari'a.

g. Any change in the scope and rates of Zakat must serve all the purposes of Zakat, as explained in Section V below, not only the secular objectives of the government. Although as eminent a leader of the Tajdid movement as Shah Wali Allah of 18th century India claimed that both the scope and rate of Zakat should change at times to meet the needs of changing society, the consensus of scholars has always been against this innovation.

## V. PURPOSES

The Islamic institution known as Zakat has one basic purpose, which is to unite the spiritual and the temporal missions of man into one organic whole. The material collection and distribution of Zakat is linked with prayer in 82 injunctions of the Kor'an. It is one of the five pillars of the faith precisely because it functions ideally as a key to the mission of Islam, which is to develop the whole of creation in submission to Allah and to coordinate the parts.

The overall function of Zakat may be summarized as the implementation of the law of Tawhid, which calls for men to accept the unique and total sovereignty of Allah and to implement in human affairs the equality and brotherhood among men which flows from this One'ness of Allah and from the equal relationship of every man to Him.

Six discrete purposes of Zakat emerge, within the overall concept of Tawhid, from the hundreds of books and articles written on it in the modern literature of Tajdid (Islamic renewal) in general and of Islamic economics in particular. In Western terms, these purposes are to promote:

- 1) submission to God; 2) distributive justice; 3) economic growth; and
- 4) education. Distributive justice may be broken down into three types:
  - 1) economic redistributive; 2) economic allocative; and 3) social/political.

The six are all of equal importance in the literature taken as a whole, though every Islamic scholar and practitioner has his own unique priorities among them. These priorities will dictate the details of definition, collection, and distribution of Zakat in any given country.

### A. Submission to God

The key to Zakat and to all of Islam are the equal and interdependent priorities on submitting both spiritual and temporal life to Allah. The call to prayer five times every day consists only of the statement of belief in Allah (the Shahada) and the call, haya alas Salah, haya alal Falah, which means come to prayer, come to material prosperity. God, prayer, and material well-being are interdependent.

This interdependency underlying the institution of Zakat is shown by the three basic words for prayer in Islam. The first is formal, public prayer, Salat, which is the minimum required for each Muslim to overcome his selfishness and weakness. The second more important form of prayer is 'Ibadat, which is submission or service to God through one's daily life, since everything a Muslim does, if performed with the right intent, is part of the life of prayer through action. Law functions in Islam to provide guidelines for both Salat and 'Ibadat, since both are social or community-oriented in nature. The third form of prayer is Dhikr, which is personal and private and is similar to the Christian concept of communion with God. Even this communion serves the temporal world by facilitating Ihsan (embellishment), i.e. by elevating or beatifying conduct into prayer.

As a religious institution, Zakat functions in three ways to help men advance in submission (Islam) to the divinity (Rububiyah) and total sovereignty or One-ness (Tawhid) of God:

#### 1. Purification

The simplest and most classic goal of Zakat is purification of the individual Muslim from the sin of avarice or greed that may have

accompanied his pursuit of the material goods of the world. Zakat and the word for purification, Tazkiyah, come from the same root, zki. The material world in Islam is considered to be entirely good, and man should develop it into material richness for himself and others. Individual wealth evidences the greatness of Allah.

But Islam recognizes that every man is tempted in one degree or another during the acquisition of his wealth to value it so highly that it becomes a substitute God. This sin of Shirk (polytheism) can best be countered and the individual purified if everyone who acquires more wealth than necessary gives part of it away to those who have more need for it than he. Zakat was instituted as a responsibility of the government to assure that at least a minimum amount of such charity goes, according to objective standards, to the truly deserving.

Even if a Muslim gives no thought to Allah in the process of earning his wealth, through Zakat he can retroactively turn the effort of earning it into a prayer or 'ibadat, providing that Zakat itself is given with the right intent. Both Salat and Zakat are designed, the one prospectively and the other retrospectively, to beatify or elevate his conduct into prayer.

The function of Zakat to purify both soul (Nafs) and wealth (Mal) is summarized by the Kor'anic exhortations: "And whoso is saved from his own avarice - such are successful," 59:9; and "You cannot attain at all unto piety until you spend in the way of Allah of that which you love," 3:92; and by the Hadith from the Second Caliph, Umar: "Allah has made Zakat obligatory on you for this very reason that the remaining wealth of yours may become pure for you." Zakat may be considered to be in the nature of a sacrament, just as is the prostration (Sajdah) in Salat,

as well as the other three "pillars of the faith," because they are all outward acts with an inward effect.

## 2. Worship of God Through Giving

The second fundamental religious goal or function of Zakat is to worship Allah by giving his bounties to other men. This is part of the basic principle of Islam that good comes more from giving than from taking, whether in social affairs, politics, or economics. This function of Zakat gives it the name, 'Ibadat Maliya, i.e. worship of God by means of property.

Although the recipient of charity has reason to praise Allah because of the goodness of those who give because they love Him, in Islam the giver praises Allah by using opportunities to use His bounties to do good. Through Zakat, Islam recognizes that the right of the needy to the bounties of Allah is superior to the right of any man to his own surplus property. Through the payment of Zakat, Muslims worship God by acknowledging the twin elements of Tawhid, i.e. the divine sovereignty of God over the material world, and the brotherhood of men deriving from the divinity of their common Creator.

## 3. In the Service of God

In Islam a unique status is given to every Islamic institution that serves to support other Islamic institutions. Since the bonds among men are just as important in Islam as the bonds between men and God, a major aim of Islam is to create society based on social, economic, and political institutions that mutually support each other in making possible brotherhood among all men in society and thereby the submission of all men to God. Any Islamic institution therefore that supports any other Islamic institution

is deemed to be "fii Sabil Allah," i.e. in the service of God.

Examples are numerous of such "parts" designed to be coordinated into a whole society in the service of Allah. One function or objective of Zakat advocated in this category is the use of Zakat funds to provide for interest-free consumer loans by private or state banks. Although Mudaraba financing can handle most commercial and investment banking requirements without the need for charging interest, there seems to be no good solution to consumer loans other than state subsidies to the banks that make such loans without interest. The source of such subsidies, provided that the loans are restricted to real consumer needs and exclude luxuries, fittingly might be the Zakat fund.

#### B. Distributive Justice

The principal issue in the introduction of Zakat is the distinction between its "religious" and "secular" purposes. Some Westernized Muslims accuse the traditionalist 'Ulama of ignoring the material purposes of Zakat in society. They fear that the 'Ulama would permit Zakat to degenerate into a meaningless social formality. In return, some 'Ulama accuse their critics of ignoring Zakat's essential spiritual nature.

The consensus is now becoming clear that the material benefits of Zakat to the recipients as an instrument of distributive justice in society are just as important as the spiritual benefits to the givers, so that Zakat should be systematically managed to promote both purposes. Either conceptual or managerial separation of the two purposes, in fact, is anti-Islamic. Abu Bakr, the first Caliph, warned that "I have to fight against any Muslim who differentiates between prayers and Zakat."

A growing majority of scholars and political leaders believes that the traditionalist and modernist approaches are both grossly naive in expecting that Zakat can have more than a marginal impact on any society, either spiritually or materially, unless the society simultaneously introduces the other Islamic institutions, such as equal sharing of risks and profits in Muḍaraba and effective dispersal of property through Islamic inheritance laws, which in concert made possible the just society of Medina under the Prophet Muhammad and his immediate four "rightly-guided" successors (Khilafat ir Rashidun). In order for any Islamic institution to function as intended in the Shari'a, all Islamic institutions, and all aspects of each, should be designed and introduced and administered as essential and interdependent parts of a coordinated strategy to transform society so that it will increasingly approximate the societal model envisaged in contemporary shari'a thought.

The purpose of distributive justice in Islam is pursued through three implementing goals, for each of which Zakat is an important tool or course of action. The first goal, economic redistributive justice, is pursued by redistributing the wealth after it is produced. The criterion for meeting this goal is equity in meeting human physical need. The second goal, economic allocative justice, is pursued both by distributing wealth during the productive process and distributing access to property created primarily by God, i.e. land and natural resources, before the productive process begins. The criterion for meeting this goal is equity in rewarding work and property for its contribution in building the material well-being of society. The third goal, social/political justice, is pursued by implementing the first two goals.

Although all three of these goals or forms of distributive justice have not been analysed together by any single Muslim scholar, each of the three occupies an important place in Muslim scholarship, polemics, and political conflict. According to Siddiqi's voluminous Survey of Contemporary Literature, Baqir al Sadr laid the groundwork for such a tripartite categorization of distributive justice into its three implementing goals twenty years ago. In his still untranslated but pioneering two-volume, 700-page, work, Iqtisaduna (Our Economics), he stressed the three Islamic bases for distributing wealth in society: need, work, and property. In an Islamic society, al Sadr argued, work and property over the long run are identical, because ownership of property derives essentially from work spent improving the original contribution from Allah.

Fully half the politico-economic arguments among Muslim activists originate in their differing priorities among these three bases of distributive justice. And increasingly central to their arguments is the role of Zakat in implementing these priorities.

#### 1. Redistributive Justice

Redistributing the wealth is given greatest importance usually in those societies where in the production of wealth the institutions of society have generated gross and chronic inequality of material wealth among individuals. The greater the failure to distribute wealth equitably during its production, through wages or stock ownership or whatever, the greater the burden on both the individual and the state to transfer the wealth of the rich to the poor. The objectives of Zakat within this goal

of redistributive justice are to:

a. Guarantee a humane standard of living. This is often termed the "social security" or "social insurance" function of Zakat, which can be accomplished either directly by financial subsidies to the family or indirectly by public works programs or assistance in kind. The objective here is not so much to lessen relative inequalities, but to eliminate physical suffering by assuring an absolute minimum income or means of livelihood to each and every individual in the community.

Zakat, of course, is much broader in scope than social security in the United States, because the eight categories of recipients include much more than the four shared with the American social security system. Although Zakat was adequate to eliminate the infrequent cases of dire poverty in the highly cooperative, early Islamic society of Medina, and although the collection base of Zakat is progressive (whereby the Zakat payment escalates, unlike in American social security, in proportion to the wealth of the payer without limit), nevertheless Zakat can not be a self-sufficient welfare fund or an adequate welfare net in modern societies. In a society where the central government tries to do most of what people or the local communities used to do for themselves, additional resources are needed, such as various kinds of secular taxes and compulsory contributory savings plans.

b. Guarantee a minimum material environment for moral living. Islam counters societal hostilities and crime by focusing on removing the occasions of sin more than by relying on sanctions or punishment, except for a few exceedingly harsh and rarely implementable punishments designed entirely for deterrent education. Just as sexual morality is promoted

by a dress and behavior code that reduces the temptations to promiscuity, so economic and social morality is promoted by avoiding the material poverty that might seduce or even force a person to steal from or otherwise harm another member of the community. This objective of Zakat illustrates clearly how its secular or material aims, like those of all Islamic institutions, are often religious in ultimate intent. Material success and spiritual success often are hardly distinguished in Islamic thought, and the attempt to do so, without an adequate framework of goals analysis, can cause severe conflicts in both intellectual and political circles.

c. Provide normative direction to government fiscal policy.

Dr. F. R. Faridi of Aligarh University in India makes the innovative suggestion, among many others, that Zakat should be looked at as an "irreducible minimum ingredient" of governmental fiscal policy, serving not so much to solve societal problems by itself as to form the "leading sector" of broader governmental social priorities. In impact it is mainly directional and normative. It is an instrument to develop and establish Islamic goals.

A major normative objective of Zakat is to generate sufficient governmental priority on helping the disadvantaged so that ideological drives toward egalitarianism can be blunted. Faridi emphasizes, as do the great majority of activists in Islamic renewal, that Islam requires private enterprise and incentives for productivity in order to achieve the aggregate levels of wealth in society so that the task of justice in its distribution and/or redistribution is manageable. Only if it cares for those who through no fault of their own cannot adequately care for themselves is it politically possible for any society to make use of the

differentials in income and property that are essential as motivations for people to produce wealth in abundance. The human factor, rather than capital, has always been viewed in Islam as the key to economic development.

Extremism in egalitarianism, however, has been an integral part of Islam since the time of the Prophet's most faithful companion, Hazrat Abu Dharr, who is invoked, for example, by Muslims sponsored by cabinet ministers in the present government of Pakistan as support for a particular position on the introduction of interest-free banking. And Islam's greatest jurists have always had to recall the Prophet's own critique of such naiveté. The 13th century "father" of Islamic renewal, Ibn Taymiya, in his book Public Policy in the Shari'a, thus recounted with the typical flavor of Shari'a analysis, according to Muslim, how the Prophet rejected Abu Dharr for an important post because he failed to balance priorities between human physical needs and human psychological incentives: "Abu Dharr was more loyal than Khalid, and in spite of that the Prophet, peace be upon him, said to him once: 'O Abu Dharr, I realize that you are weak. I wish to you what I wish to myself. Never try to be an overseer to any two persons, nor try to be a guardian to an orphan.'" The consensus is growing rapidly throughout Islam that only with equal emphasis on distributive justice and economic growth can any society fulfill the commands of Allah.

## 2. Economic Allocative Justice

The second means to achieve distributive justice in Islam is to disburse the wealth of society while it is being produced. This task of Zakat is termed its "allocative role" by Dr. Muhammad N. Siddiqi of the

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King Abdul Aziz University in Jeddah, who identifies the "allocative" proponents in his 74-page analytical summary accompanying his exhaustive bibliography of 700 major sources on Islamic economics.

The "economic allocative" goal of Zakat within the overall purpose of distributive justice is to optimize the sharing of wealth during the process of producing it, or, negatively viewed, to facilitate the production of wealth without introducing gross disparities in its distribution. Whereas redistributive justice focuses on providing social insurance through Zakat and on dispersing wealth through Islamic inheritance, allocative justice focuses on promoting opportunities to participate in producing wealth in society and on just "wages" from such participation.

Zakat serves this allocative goal in two ways: indirectly by increasing employment through the leverage it provides in the macro-economic management of investment supply and of consumption demand; and, directly, through its role in disbursing the benefits of property ownership.

In the current Islamic debate, a key issue is this allocative role of Zakat, because many activists support Zakat almost exclusively as a tool to make possible interest-free banking, and because many of these same activists believe that eliminating interest in the financial system is critical, if not a "cure-all", in their determination to transform Muslim countries of the present into Islamic countries of the future.

a. Employment

As discussed above under the institution of Mudaraba financing, Zakat increases employment as a means to broaden the sharing of wealth in society because it penalizes the accumulation of idle wealth. As soon as wealth is earned, the burden of Zakat on it strengthens the propensity to

feed this wealth back into the economy either through investment or consumption. The incentive to avoid the Zakat "tax" by rapid reinvestment is a tool of supply-side economics and is designed to increase both production and productivity and thereby to increase both the demand for labor and the return to labor. The alternative "tax-avoidance" tactic is to return the wealth into the economy by purchasing consumer goods. This is a more direct and immediate stimulus to the economy and also results in rising employment.

The effect of Zakat on labor as a factor in economic production should be even more profound, according to many Islamic economists, because the more rapid circulation and greater availability of capital would lessen the role of scarcity in its value. In the words of Mahmud Abu Saud, former Professor of Economics at the University of Cairo and Advisor to the State Bank of Pakistan: "by penalizing the hoarding of money capital ... labor will be the most demanded and scarce element of production." This would shift the bias in developing Islamic countries away from relative capital intensivity, which is a Western concept believed to be catastrophic in its actual application in much of the Third World, and would permit economic growth based on a balance between capital and labor. Many Muslim economists believe that Zakat thus would help eliminate the imbalance between these two factors of production, which has caused a great deal of the economic injustice throughout the Muslim world.

A few Muslim political-economists even argue that the rate of Zakat could and should be orchestrated to accomplish this aim, but they are vehemently attacked by many 'Ulama and by a substantial majority of Muslim economists who claim that Zakat should never be permitted to

degenerate thus into a mere tool of secular fiscal policy. The use or non-use of Zakat by the rightly-guided Caliphs in Medina for purposes of fiscal policy provides the arena for this particular debate. Since Zakat originally encompassed a number of different kinds of taxes, which were usually not distinguished from Zakat in the Fiqh until almost 200 years later, the question, like many others in shari'a economics, is often addressed simply as a matter of definition.

The consensus is coalescing into a recognition that the task of allocating wealth during the production process in an Islamic society cannot be restricted to the field of macro-economics, but must involve equally some direct action at the micro-level in disbursing and dispersing the benefits of property ownership.

#### b. Property

Modern Islamic thought closely links work and property. Not only should work be the source of property, but property should be an incentive for work.

##### 1) Speculative Property

In modern Islam, speculative investments are Haram (forbidden) because they are designed to derive profits from the simple elapse of time rather than from inputs of labor and entrepreneurship. This is contrary to the powerful religious work ethic in Islam. Speculators are equated with beggars, because their profits come from other men's labor. They function therefore as leeches in society. This is clearly against the teachings of the Prophet: "Beg not anything from people"; and against the teachings of the Second Caliph, Umar, who is a major source on almost every modern economic issue: "No one of you should stay away from seeking

livelihood and say O God Give me sustenance"; and "Seek of the bounty of God and be not a burden on others."

Zakat would discourage such speculative and unproductive investment because it would tax non-working capital tied up in land, precious metals, and commodities held for speculative purposes, which are the normal hedges that trigger so much of the stagflation in modern economies. Although such items of property are normally beyond the reach of tax authorities, many Islamic activists believe that assessing such speculatively-used property should be a major aim of Zakat.

## 2. Equity Ownership

The most powerful allocative force in Islamic economics may be the use of Zakat to broaden capital ownership. Muslim professionals skilled in modern finance know that leveraging wealth to make more wealth is the source of prosperity at the micro level of individual incomes, as well as more generally. The leverage of Zakat would be minimal if it were used only as transfer payments for immediate consumption by the poor. A strategy of explosive potential in the allocative process is to earmark a portion of each individual recipient's Zakat payment for productive investment in profitable enterprises in order to give the recipients equity ownership and a continuing income.

In his landmark paper, entitled "Zakat and Fiscal Policy,"  
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delivered in Jeddah, Saudi Arabia, at the First International Conference on Islamic Economics in February 1976, and published in 1980 in Khurshid Ahmad's conference proceedings, entitled Studies in Islamic Economics, Dr. F. R. Faridi outlines seven ways in which the use of Zakat to broaden

capital ownership would be "an effective instrument in the fulfillment of the allocative as well as the distributive functions of fiscal policy." This strategy of buying stock for Zakat beneficiaries, in addition to simply transferring money for consumption, would:

- a) Minimize the bias in consumption priorities inherent in transfer funds, and thus both stimulate production and reduce inflation;
- b) Dovetail with overall investment priorities of the economy and maximize the multiplier effect of Zakat on both income and employment;
- c) Gradually eliminate poverty by providing a base of income-producing property particularly to the working poor (the Masakin or second category of Zakat beneficiaries), which contrasts with the present system wherein the same set of people receive recurring financial support and thereby become institutionalized in their financial and social status;
- d) Give the poor a vested interest in the success of private enterprise as the backbone of productivity and a continuing benefit from the success of private enterprise;
- e) Provide work incentives, because eventually the norm in society would be for every worker to earn as much from his dividends out of the profits of his firm as from his own wages. It would be his option to take his dividends as profits or reinvest them as additional productive wealth;
- f) Reduce the political tendencies toward class conflict by rapidly multiplying the number of worker-owners and narrowing the gap between those who earn from capital and those who earn only from their labor;

g) Expand the base for Zakat assessments by moving the thousands or millions of new capitalists eventually above the Nisab exemption level.

Enlightened by practical experience in employee stock ownership plans beginning in 1979 in Saudi Arabia, many Muslims believe that such a program of expanded stock ownership would have revolutionary political implications, because it would not reduce the capital ownership of those who are already capitalists but rather would make available to them additional equity capital, either voting or non-voting. This would remove the appeal of Marxism, which seeks to abolish private capitalism in order to eliminate the gross disparities of wealth associated with it in the past. Marx considered it politically impossible to turn everybody into a little capitalist and thereby to eliminate the defects of capitalism by creating a truly capitalist society.

Many modern Muslims believe that through the use of Zakat, Islam can make mass capitalism a political reality and also in the process eliminate the monopolies that thrive on hoarded wealth. Zakat is a religious assessment specifically designed by Allah to mesh with all the other Islamic economic institutions in a coherent strategy of productivity sharing (Sharakat). In a religious society, where Zakat is recognized as a basic goal-setting or normative institution, it would be possible to base all economic productivity on the twin principles that property should be a major incentive for work and work should be the source of property. And in the process, the third basis for distribution of wealth in society, namely, need, should be reduced to an easily manageable level.

Such, at least, is the theory in modern Islamic economics, which has influential backers ranging from Bani Sadr, the author of one of the great classics in the field, in Iran, to Ghazi al Gusaibi, Poet Laureate and Minister of Industry and Electricity in Saudi Arabia. In his masterly article, "The Islamic Welfare State and Its Role in the Economy," Dr. Umar Chapra, Economic Adviser to the Saudi Monetary Agency, points out that in Islam the term welfare means prosperity, i.e. Falah. The objective therefore is to level up, not down. Islamic teachings, he contends, are the best route to both wealth and justice. "In reality, if the Islamic teachings of Halal and Haram about income and acquisition of wealth are sincerely followed, ... there will remain no gross inequalities of income and of wealth in society."

### 3. Social/Political Justice

Although the first and second goals of redistributive and allocative justice both promote the third goal of social/political justice, this third goal within the overall purpose of distributive justice in Islam is distinguished in some Shari'a analysis as a separate field of study and action. The failure to stress the role of Zakat in the formation of an Islamic social and political environment has been attacked just as vigorously as the failure to appreciate its underlying spiritual purpose. Two specific social/political objectives of Zakat have received most attention:

#### a. Political Power

Perhaps the most sensitive issue in the modern discussion of Zakat is its political impact. Such sensitive issues tend to be treated best in the fora provided by Muslims living either temporarily or permanently

in the United States, who invite experts from all over the Muslim world to their conferences. Typical is the discussion paper by the young economist, Dr. Mabid Mahmoud, entitled "Frictions, Power Rationing and al-Zakat," published in Proceedings, Third National Seminar, Association of Muslim Social Scientists, Gary, Indiana, May 1974. Mahmoud supports Zakat as a powerful means of redistributing political power, which he believes to be a direct function of wealth.

Whereas Islamic inheritance laws are designed to redistribute wealth justly between the present and future generations, Zakat is designed, in Mahmoud's view, to remove un-Islamic concentrations of both economic and political power within the present generation. A broader sharing of political power would be promoted directly by such means as making landed property more accessible to the tax authorities through Zakat and more indirectly by designing Zakat to "check accumulation on an asset by asset basis, taxing more remunerative assets more heavily, for they provide a greater prospect for power accumulation."

Much more effective as a means to diffuse political power, of course, would be the use of Zakat to broaden capital ownership. This would maximize the role of individual talent and effort both in producing and sharing wealth and it would expand the base and wealth of the middle class at the expense of concentrations of power both in the chronically rich and the chronically poor.

b. Social Solidarity

Those who look on Zakat as a tool of political revolution are generally opposed by those who believe that Zakat must never be used in ways that might politicize it unnecessarily, because this would compromise

its essential spiritual nature and even its very existence as one of the five pillars of the faith. It should not be forgotten that in 1400 years of Islam, Zakat existed as a governmental institution only under the first four caliphs and the Umayyad, Umar bin Abdul Aziz. Sadaqat as an institution of private, voluntary charity has survived much better, but in 1974, during the high tide of Westernization, Saudi Arabia abolished the facilities of the government as a middleman even for voluntary Sadaqat.

The more spiritually motivated believe that any political changes engendered by Zakat should come about through its psychological and social impact. Abu Saud believes that Zakat should aim primarily at reducing the very power of wealth and money in society and not at reducing or eliminating the power of those who currently hold such wealth. He believes, for example, that the greater availability of capital in an Islamic economy with Zakat will increase competition and reduce profit margins so that people will be distinguished not so much by their conspicuous consumption and by their money in powerful banks as by their productive enterprises. Faridi believes that Zakat should be able to serve, by the very delineation of its beneficiaries in the Shari'a, to protect social welfare and other priorities of Islamic distributive justice from the political and economic whims or hidden agendas of any government.

The former leader of the Muslim Brotherhood in Egypt, expelled by Nasser and currently Director of the Islamic Center in Geneva, Dr. Said Ramadan, in his classic book, Islamic Law: Its Scope and Equity, emphasizes that Zakat originated as an instrument to build social cohesion among the faithful and not political conflict. Zakat was levied only on

Muslims and could not be remitted by services, as could, for example, the poll tax, Jizyah, by service in the army. Zakat, says Said Ramadan, is designed to promote social uplift through the collective care of the deserving poor and to promote social cohesion and harmony through the concern of individual Muslims for each other. Whatever Zakat achieves, warns Ramadan, should be based on conscience and on social justice prompted by faith, not on class struggle or on fratricidal warfare among Muslims. Zakat, in this view, is not a weapon of political revolution as much as a weapon to make such conflict unnecessary.

The social/political goal of Zakat very clearly is brotherhood, which is one of the two elements of Tawhid. For this purpose, economic and social justice are mutually supportive. Chapra lists "social and economic justice" as one of the six functions of any Islamic state and points out that social justice, which he defines as equal treatment for equal contributions to society, presupposes conditions of economic justice. "The only criterion for a man's worth is character, ability, and service to Islam and humanity. Said the Holy Prophet: 'Certainly God does not look at your faces or your wealth; He looks at your heart and your deeds'."

Afzal ur Rahman points out in Volume III of his lengthy book, The Economic Doctrines of Islam, that the legal pillars of the economic system of Islam, which he identifies as the law of inheritance, Zakat, and zero rate of interest, would cause friction, delays, interruptions, and strife in their operation, without the all-informing moral environment of Infaq, which is the spirit of giving in the way of Allah. This spiritual basis of Zakat he considers to be "the lubrication that makes the system work with a minimum of governmental coercion and therefore to work at all, since no system based on governmental coercion can be Islamic."

### C. Economic Growth

Two other purposes of Zakat may be distinguished in the programs of Islamic renewal, in addition to submission to God and to the three forms, just discussed, of distributive justice. These two are economic growth and education.

The single most appropriate catchword to summarize what the new discipline of Islamic economics is all about is Faridi's phrase, "growth with social justice." Equally important are growth in the overall material wealth of society through the most efficient investment of economic resources (al-Amwal) and justice among men through its most effective use by and for individuals.

Etymologically, Zakat has two meanings. The first is "sweetening" or "purification." The second, and probably the older meaning, is "growth." One says in Arabic, "zaka az-Zar," meaning, "the plant grew up." In the Shari'a, it has always had both meanings, with the translation depending on the context. The dual meaning is expressed in the Hadiths: "God increases the reward of Sadaqat," and "No wealth decreases because of Sadaqat." This means that whatever community or individual obeys the law of Zakat will receive from Allah both spiritual and material rewards.

One of the leading practitioners of Kor'anic linguistic interpretation, Dr. Abu Saud, teaches that the growth element of Zakat refers to its role in circulating wealth in productive enterprises. The very purpose of the ban on interest of any kind or amount was "so that this wealth may not circulate solely among the rich among you" (Kor'an 59:7), and so that it would instead be dispersed in enterprises giving every man both a productive livelihood and an incentive to take risks and multiply the bounties of Allah.

Wealth has been ascribed over and over again in the Kor'an to man, and not either to inert material goods (or their money equivalent) or to Allah. This is the meaning of the Kor'anic phrases, "O ye who believe! Spend for yourselves of the good things which ye have earned and that which ye bring forth from the earth" (Kor'an 2:7), and "If you lend unto Allah a goodly loan, He will give it increase manifold" (Kor'an 64:17); and also the bold teaching of Jesus, similarly interpreted by the leading supply-side economist in the United States, George Gilder, "Cast your bread upon the waters, and it will return to you manyfold." Hamidullah, in his widely circulated Introduction to Islam, teaches that "it is on the basis of this fundamental principle that Islam has constructed its entire economic system."

This is why the Shari'a rules of collecting Zakat, as discussed above in Section III, provide rates that vary among collection categories in order least to burden wealth that has the greatest human input, either in labor or capital. These rules serve thus to reward human effort in transforming natural resources into wealth. This is also why the rules of distributing Zakat, as explained by Abdul Aziz Shaik in his masterly, "Concept of Zakah: A Survey of Qur'anic Texts and Their Explanations in Shari'ah and Contemporary Economics," are designed to help people out of financial troubles and not to make them dependent on welfare. Any such dependency would increase the required collection of Zakat. This, in turn, would burden economic productivity and thereby create a vicious circle destroying the very possibility of economic growth for which Zakat is intended.

Economic growth with social justice, which summarizes four of the six purposes of Zakat, calls for sharing prosperity, not sharing poverty.

This prosperity depends on Zakat in no small measure because Zakat is an important policy tool designed to penalize the accumulation of idle wealth, which no developing country can afford. The abolition of Riba (interest) and the institution of Zakat as an enforcement measure are designed to accelerate the flow of funds from unproductive, sometimes non-monetized and idle sectors of the economy, into maximal economic activity both as increased capacity for production and as increased demand for both consumer and producer goods. The hope is that this accelerated turnover of wealth will produce a national multiplier effect on output sufficient to break the poverty cycle, which all Muslim economists have concluded seems to be immune to Western economic theory.

After half a century of experimenting, or at least trying to experiment, with both Western capitalism and Western socialism, Muslim intellectuals and politicians both are reaching the conclusion that they have no alternative but to advocate return to the economic theory that lies both explicitly and implicitly in the revelation of the Kor'an and in its interpretation through the actions and teachings of the Prophet Muhammad and his Companions.

The traditional Islamic institutions, like Zakat, worked well in the model Medina State, but they have lain fallow as theoretical curiosities during the past millenium. Western students of the Shari'a generally know almost nothing about them, and until the past decade neither did most Muslim lawyers. The revival of Islamic religious commitment and the feeling that Western institutions have offered no promising alternative to those of Islam have combined to reinforce each other in building both intellectual and political commitment to Tajdid or Islamic renewal. In this renewal, a major commitment is being made to Zakat.

#### D. Education

The last of the six purposes of Zakat evident in the Tajdid movement is typically Islamic. This is its purpose to form and instill an attitude of mind. The importance of this purpose derives from the Muslim cultural emphasis on the importance of the abstract in controlling the concrete. Although the material world is no less real in Islam than the spiritual, nevertheless what one sees in this world should be governed by what one does not, namely, by Allah working through each individual Muslim. Submission to the will of Allah is largely a task of education, and education in Islam is a lifelong duty directed toward the three conditions of Islam: belief, prayer, and giving rather than taking in all aspects of life. Thus the first verse in the Kor'an, other than the short opening chapter (the Fatiha), announces: "This Kor'an is the Book of Allah whereof there is no doubt. It shows the right path of life to those pious people who believe in the unseen, establish Salat, and spend of that which We have bestowed upon them." The educational purpose of Zakat contains three major goals:

##### 1. Countering Riba and Decadence with Infaq

In Islam, the term for interest or usury, Riba, denotes much more than the physical taking of money. Riba is the act of violating both elements of Tawhid. It consists in claiming an unjust share in natural resources created by God, which is regarded as claiming divinity. And it consists in claiming an unjustly large share of benefits or an unjustly small share of the risks in any commercial transactions, which is regarded as a crime against brotherhood. Similarly, it consists of hoarding wealth that should be circulated to create new wealth for all men. Riba is injustice in the ownership and distribution of wealth and income. More importantly and profoundly, however, Riba is an attitude of mind. It is the attitude of "taking" in one's

relationships to God and to one's fellow men. It is selfishness and egoism.

The major educational goal of Zakat is to counter this attitude of Riba with an attitude of Infaq, which is a broad term encompassing both Zakat and Sadaqat. Infaq may be defined both as actually giving from one's excess wealth and as the inclination to give rather than take in all one's relations with God and man. The principal founder of the Tajdid movement in modern Pakistan, Maulana Maududi, taught in his Fundamentals of Islam that the objective of Salat is Islam, i.e. submission to God, and the objective of Zakat is "the inclination of Infaq."

The great founder of Tajdid in India, Shah Wali Allah (Walliullah), who was an exact contemporary of the Arab, Abdul Wahhab, and lived during the period of Mughul decline, carried this thought further, perhaps building on the ideas of Ibn Khaldun. Wali Allah taught that Riba or selfishness is the cause of both conspicuous earning and conspicuous consumption and that these are the cause of societal decadence. The role of Zakat in his view is nothing less than an instrument of moral rearmament aimed at the survival of civilization.

## 2. Countering Shirk with Rububiyyah

The first element of Tawhid is recognizing the divinity of God and acknowledging his sovereignty over both the material and spiritual in life. This acknowledgement, in turn, requires recognition that money is perishable and should not be used as a security blanket to avoid the risks of productive enterprise or vainly to avoid the ephemeral nature of one's life on earth. Abdul Aziz Shaik, Chairman of the South African Zakaat Fund implemented in his Muslim community, explains that "Islam forbids money

to acquire the divine qualification of immortality and ordains that all beings except Him must depreciate according to the Law of nature." The Kor'an stresses that, "Everything is perishable except Him" (Kor'an 55:27).

Professor Mahmoud Abu Saud cites this verse and adds: "It is only God - our Rabb - who is Everlasting and Infinite. To ascribe this divine qualification to anything is tantamount to Shirk, i.e. association with God. This is a denunciation of the essence of belief in God according to Islamic tenets. All monies must depreciate by lapse of time and it is the duty of the Islamic state to impose and collect a 'tax' or rate of depreciation in accordance with Islamic jurisprudence. This tax is Zakat." Abu Saud rejects the narrow interpretation that Zakat should be levied only on the eight commodities listed in tradition, and advocates the now majority view that Zakat should be levied on money directly so it will carry a cost and lose its artificial supremacy as a value over the genuine and depreciating goods it represents.

One educational goal of Zakat therefore is to direct man's attention to the uniquely everlasting nature of God, which is part of His divinity or Rububiyyah. Only from such a perspective can any man or any community of men rise above the petty temptations of life and apply consistently the spirit of giving inherent in the Shari'a. Only when this spirit infuses the Muslim community will Islamic institutions work as intended and justice reign on earth. Only when Zakat is properly instituted as a religious, economic, political, and educational pillar of Islam can men begin to lessen the discrepancies between the ideal of Islam and the reality.

### 3. Building the Spirit of Umma

Zakat is an institution of community giving. Not until the third caliph, Uthman, were Muslims permitted to pay Zakat directly to the charity of their choice and then only one-third of their obligatory Zakat was permitted this discretion. The community or Umma is a basic value in Islam. The political life of every man in Islamic teachings may be viewed as a series of concentric rings of loyalty toward the fellow men around him, or as a series of ever-broadening identity affiliations or solidarity groups. At every level of political life, whether family, tribe, or nation, all the way up to the human species, this collective awareness or "Asabiyyah" of the group generates legitimate authority of the group over its members. This Assabiyyah is the glue that holds society together for everyone's benefit without debilitating internal conflicts.

Since there is no concept in Islam of the corporate state or of a social contract between the "state" and the people, whatever institutions strengthen the feeling of community are essential to peace and stability. Zakat was a pillar of the early Muslim community, before it became a far-flung empire, precisely because it epitomized the concept of community giving, and because it served to educate the individuals of the community that in collectivity there is a force stronger than exists in any individual or even in an aggregate of individuals.

Most specifically, the institution of Zakat should function to teach the community's members that justice comes not from internal struggle but from cooperation based on giving and on trust in one's fellow men, which in turn must be based on Salat (community prayer) and on 'Ibadat (either individual or community prayer in action) and on an underlying

faith in and love of Allah:

Although Western businessmen may be most concerned with the impact of the new movement of Tajdid on the elimination of interest in banking and insurance, this manifestation of change is nothing more than the tip of an iceberg. In this analogy, the supporting part of the iceberg is the institution of Zakat. Rapid growth of the intellectual and political movements of Tajdid in much of the Third World suggests that we must now consider the possibility that Zakat has become merely one of several icebergs floating in an ocean of Islam, which was always there but now has begun to rise and flow.

A GLOSSARY OF ARABIC TERMS USED IN THE TEXT  
ISLAMIC COMMERCIAL LAW IN CONTEMPORARY ECONOMICS

- Adhan The Muslim call to prayer, chanted five times daily, page 55.
- Adl' Justice, page 29.
- al Adl' wal-Ahsan Justice with Kindness, a slogan adopted in Pakistan by those who want to build upon it an Islamic socialist order, page 29.
- Ahl adh Dhimma Christians and Jews, literally people or family of the Dhimmis, page 9.
- Ahsan Kindness, part of the slogan al Adl' wal-Ahsan, page 29.
- Amil The entrepreneur or working partner in a contract of Muḍaraba; one who uses economic resources (Amwal); page 19. Other terms for this working partner are Darib, Muḍarib, and Muqariḍ.
- Amilin-alaiha Collectors and administrators of Zakat, one of the eight categories of eligible recipients of Zakat funds, page 74.
- Amwal Economic resources, consisting of natural resources provided by Allah and the product of human labor and ingenuity applied to increase their value, pages 19,103.
- Amwal il Batinah Non-apparent or non-physical wealth, traditionally not subject to the Zakat levy, such as money and debts; in modern Pakistan this term refers only to whatever by administrative decree is not subject to Zakat, designated as Second Schedule items, including physical inventories, agricultural produce, and metals, page 79.
- Amwal iz Zahirah Apparent wealth normally zakatable; in modern Pakistan this term refers only to whatever actually is decreed to be subject to the Zakat levy, designated as First Schedule items, including shares in corporations that pay dividends during the Zakat year, page 79.
- Assabiya Group loyalty, spirit of belonging to a community at the level of extended family, tribe, nation, or human species; first developed as a basic concept in Islamic political science by Ibn Khaldun 700 years ago, as in Assabiya Islamiya, page 109.

Bai Muajjal A term in Islamic commercial law referring to sale with the price of the item payable on a deferred basis, defined in the Kitab al Bai (Book of Sales); permitted in modern Pakistan as an alternative to Muḍaraba and to interest, and recommended for short-term financing of consumer durables and agriculture, but regarded as dangerous because it could degrade into the functional equivalent of interest, pages 36,37,50,65,67,68.

Bai Salam A term in Islamic commercial law referring to a technique used to finance farmers' planting and irrigation of crops in return for the sale of the not yet existent crop at a price fixed in advance. This is permitted by the Shari'a only subject to very stringent restrictions in order to avoid unjust enrichment by financiers, pages 35,37.

Darib The entrepreneur, working partner, active partner in a contract of Muḍaraba, who uses funds supplied by the capitalist, financier, silent partner; also called Amil, Muḍarib, and Muḡariḍ, page 19.

Dariba Sing. Dara'eb. A series of onerous taxes instituted during the Abbasid Caliphate in the 10th and 11th centuries and not included within the levies permitted by the Shari'a, page 72.

Darura The concept of "necessity," used as a form of Ijtihad (independent reasoning) in order to determine the legality of an action not clearly analogous to specific guidelines and precedents found in the Kor'an and Sunna. Some jurists contend that Darura is an umbrella concept including both the sense of equity (Istiḥsan) and the sense of pragmatic custom (Istiṣlah) popularized by the schools, respectively, of Hanifa and Malik, pages 35-36.

Darura wa Hajat Necessity and Need, the same as Darura.

Dhikr Personal and private communion with Allah, from dhikr = remembering, as distinct from the public, group prayer known as Salah. Can include many kinds of such prayer: Tasbih (glorification), Ihsan (beatifying conduct), Inabah (return to Allah), Qurb (approaching Allah), Tariqat (road to Allah), Suluck (journey unto Allah), and Tasauwuf (multi-step ascent to Allah), and Mi'raj (ascension to Allah), page 84.

- Dhimmis Those who enter into a compact (Dhimma) with Muslim believers, whereby the Dhimmis agree to respect the rights of Muslims to their faith and the Muslims in turn agree to provide a collective and indefinite pledge of security (Aman) for the life and property of the Dhimmis. Violation of this pledge by Muslims makes them liable to blame (Dhamm). The community of Dhimmis is known as Ahl adh-Dhimma (People or Family of the Compact) and as Ahl al-Kitab (People of the Book). Traditionally Dhimmis are Christians, Jews, Magians (Zoroastrians), Samaritans, and Sabians, i.e. those whose religion is based on a Scriptuary.
- Din Religion, consisting of faith (Iman) and obedience (Islam). In Islam there is only one true Din, i.e. Islam, but there are several paths (Shari'a) to this Din, namely those of Moses, Jesus, and Muhammad. In this sense, all People of the Book are Muslims, because objectively they all believe in the same God and all try to obey His will; page 25.
- Divan The body of advisers to an Arab ruler. After the modern cabinet system of government was introduced, the Divan generally was the ruler's private secretariat, though some Arabs translate the term Divan as cabinet, page 9.
- Fa'ee Immovable property gained from non-Muslims in war and subjected to taxes, mainly the land tax, Kharaj. Some consider that Fa'ee was the land tax on non-Muslims, whereas Kharaj is a broader term referring to all land taxes due from both Muslims and others, page 72.
- Falah Human well-being or welfare in the sense of material prosperity; thus the Islamic welfare state is based on the work ethic and leveling up, rather than on dependence and leveling down, as the term is used in the United States, pages 55,84,99.
- Fatwa The answer by a Mufti to a legal or theological question put to him by a party to a conflict. In accordance with the rules of this institution, known as Futya, the answer must address a practical issue not a theoretical case, but treats only points of law not the facts of any case. Either the judge or a ruler may also seek a Fatwa to resolve a general question of public morality, pages 37,44.

fii Sabil Allah In the cause of Allah, referring broadly to every act and law supporting the establishment of an Islamic state, and within the law of Zakat to one of the eight categories of recipients, pages 74,87.

fir Rikaab One of the eight categories of permissible recipients of Zakat, specifically for ransoming slaves and more broadly political prisoners, page 74.

Fiqh Most broadly, the Fiqh is "the understanding of the divine code of life" (Maududi), deriving from the verb faqaha (to comprehend) and the noun Fiqh (comprehension). More narrowly, Fiqh is "the knowledge of the classification of the laws of Allah" (Ibn Khaldun) into the five categories of commanded (fard), recommended (masnun), permissible (mubah), reprobated (makruh), and forbidden (haram). Using the definition of Maududi, whereby the divine code of life is Din, the Fiqh is Islamic jurisprudence, of which there are several schools of interpretation (Madhahib) serving as different but equally acceptable roads (Shari'a) to its understanding, pages 19,73.

Fugara Sing. Faqir. The poor, the first of the eight categories of eligible recipients of Zakat; refers to the chronically destitute and the temporarily unemployed who have no income at all, as distinct from the Masakin, who have the bare necessities but less than the Nisab comfort level deemed to be minimally acceptable in any given society, page 73.

Fuquha Sing. Faqih. Jurists, especially those who specialize in the derivative details of the Shari'a for use in courts of law, as distinct from the Mufti, who specialize in the principles from which the details derive, pages 18,35.

Ga'nima A tax on vanquished unbelievers consisting of movable spoils of war, including prisoners, with 1/5 going to the poor and 4/5ths to the soldiers, as distinct from the Fa'ee on immovable spoils of war, page 72.

Gharemin Debtor, one of the eight categories of Zakat recipients, page 74.

Raji The assembly of Muslim pilgrims gathered to perform collective, public prayer (Salah) in Mecca, the headquarters of the first prophet, Abraham, as a symbol of the unity of all the world's Muslims in the Umma Islamiya (the Islamic community); refers also to the travel of the pilgrims toward the place Abraham and his eldest son, Ismail, selected as the center of permanent peace among all peoples, page 72.

- Halal Permissible, i.e. the opposite of Haram, page 99.
- Hanafi The school of interpretation of the Shari'a built on the teachings of Abu Hanifa in Bagdad in the eighth century A.D., who developed a theory of Istihsan or juristic preferences (also known as Istihbab or preference) to use reasons of public interest where the rules of strict analogy could derive no direct relevance of the Kor'an and Sunna to a particular issue or question. Since he was geographically distant from Medina, where the local customs could serve as evidence of the Shari'a, he resorted to what Western legal theoreticians might call rationalist equity, pages 35,74,77.
- Haram Absolutely forbidden and abominable; one of the five categories of value used in the Shari'a, which are fard or wajib (expressly commanded in Shari'a or Ijma); masnun, mandub, sunna, or mustahabb (recommended or desirable); mubah or ja-iz (permissible or indifferent); makruh (reprobated); and haram. This spectrum from good to bad expresses the emphasis of the Shari'a on moral values, in contrast to the Western emphasis on simple legality or illegality. This spectrum also expresses the Shari'a's major function, which is to educate rather than to enforce, pages 95,99.
- Hiyal Sing. Hila. Legal devices to use the technicalities of the Shari'a in order to violate its spirit or intent, pages 27,38,55.
- 'Ibadat A form of prayer consisting of submission or service to God in one's daily activities, and especially through the five 'Ibadat or pillars of the Islamic faith (reciting the creed or Shahada; daily prayer or Salah; almsgiving or Zakat; fasting or Sawm; and the pilgrimage or Hajj) all of which dispose the individual to understand and practice the will of God. The word 'Ibada comes from the root 'Abd or slave, and consists of four qualities in reference to Allah: fidelity, obedience, reverence, and knowledge of His law, pages 84,85,109.
- 'Ibadat Maliya Worship of God through property (Mal), specifically through giving one's wealth to the poor in Sadaqat or Zakat, page 86.

- Id al Adha The four-day feast of sacrifice commemorating Abraham's sacrifice of his son Ismael and indicating the Muslims' willingness to sacrifice for God, starting on the 10th day of the last Muslim month, Dhul al Hijjah, and corresponding to the last four of the six days of ceremonies during the Hajj, page 72.
- Id al Fitr The three-day festival after the end of the month of Ramadan. Fitr means "breaking the fast," p. 7.
- Ihsan A form of prayer whereby temporal acts are elevated or "embellished" into spiritual merits, page 84.
- Ijma One of the four roots of Islamic law, the others being the Kor'an, the Sunna (consisting of the accounts of what the Prophet said, did, and by silence approved), and reasoning by analogy (Qiyas). Ijma means the consensus of all Muslims, but is expressed as a consensus among Muslim scholars. Since Muslim scholars are not organized and cannot be polled, Ijma can be established only retrospectively, i.e. by showing that particular opinions or institutions have become accepted in scholarly writings. Some Westernized Muslims believe that Ijma can be established only through formal procedures of one-man, one-vote in parliamentary democracy, 28,36.
- Ijtihad The use of reason to determine good and bad in the absence of a clear text of the Koran and Hadith applicable to the issue at hand. Shafi'i, one of the four founders of still-used schools of law in Islam, permitted Ijtihad only through the use of analogy (Qiyas), in order to counter the tendency of the Hanifites to use personal opinion (Ra'y), but he permitted analogy based on the inner meaning of a text (Tawil) rather than only on its apparent meaning (Qiyas tam). Modern Ijtihad differs from Qiyas, because it refers to analogy based not on a single legal provision but on the entire body of Shari'a. This application of the totality of the Shari'a requires a conscience illuminated by personal piety and a mind educated, disciplined, and refined by intense and profound study and contemplation of all the sources of Islamic law. Few Muslims thus can qualify as Mujtahids or practitioners of Ijtihad, pages 36,78.
- Ikhtilaf The scholarly discipline known as "controversial questions," which consists of formal disputations among the four Sunni schools of law in order to clarify their differences by identifying their differing sources, motives, and resort to Ijtihad, page 73.

- Infaq The act and spirit of giving. Includes both voluntary charity (Sadaqat) and obligatory charity (Zakat), pages 15,58,70,102,107.
- Iqtisad Economics, page 89.
- Ishlah Reform, used in this study to denote the response of "modernist adaptation" to the challenge of an encroaching, foreign culture, page 6.
- Islam Submission to God; also the religion of Islam, which has the mission to develop the whole of creation in submission to Allah and to coordinate the parts, especially the temporal and spiritual elements, pages 55,83,84,107.
- Islamic The term that describes a government or an institution managed by Muslims in accordance with the spirit of the Shari'a. No Muslim country has yet become Islamic, because none has yet revived all the basic Islamic institutions of the first-century Medina state, including interest-free finance and Zakat, pages 3,72,78,79,93.
- Islamic accounting A sub-discipline of the discipline of Islamic economics, essential to the success of Muḍaraba banking, Muḍaraba insurance, and Zakat, pages 12,80.
- Istihṣan A theory of reasoning developed by Abu Hanifa in Muslim first-century Iraq to augment the Hadith with rational equity based on personal opinion. Literally means "choosing for better," often known as Istihbab or "preference," and translated as "favorable construction," which means that one interprets the Kor'an and Sunna to reach the decision that a priori seems most rational in serving one's own concept of justice, pages 35,78.
- Istiṣlah A theory of reasoning developed by Malik ibn Anas in Medina to augment the Hadith as a source of law by reference to the customs or practice of the Medinan society in the second Muslim century. Also known as Maṣlaḥa, from the root ṣ-l-ḥ meaning "reconciliation" or "goodwill," which acquired in the Fiqh the meaning "public policy." Istiṣlah, which means "seeking the better," was coined as a term by al-Ghazali to distinguish it from Istihṣan and to emphasize the element of pragmatic positivism, pages 35,78.

- Jihad The commitment to stake one's life and everything else to establish the kingdom of God on earth and thereby remove the lordship of man over man, as well as to establish the sovereignty of God over one's personal life. This is sometimes referred to as the sixth pillar of Islam, for which the first five, Shahada, Salah, Zakat, Sawm, and Hajj are merely steps in preparation. In self-defense, Jihad also means military warfare, page 74.
- Jahiliyya The "times of ignorance," i.e. pre-Islamic Arabia, page 71.
- Jizyah A tax on able-bodied non-Muslim males in substitution for the obligation to perform military duty. Comes from the root word Jaza, which means "to give what is due in return for something given," i.e. in return for the Dhimma or compact whereby the Muslim community agreed to protect the Jews and Christians in life and property from external aggression and internal harassment. Also known as Jijia and as Kharaj al-Jizyah or "poll-tax," the other form of Kharaj being the land tax imposed on both Muslims and non-Muslims, pages 71,102.
- Kalam Systematic rational theology, practiced by Mutakallimun, and pioneered by the Mutazillites in 3rd and 4th century Islam as a way to combine the emphasis on revelation (found in the Traditionists) and the emphasis on pure reason (found in the proponents of secular Greek philosophy). Whereas al-Ashari combined these two elements, so that Kalam became a rational methodology to support revelation, later al-Ghazali developed a triple synthesis by incorporating the mysticism of the Sufis into Kalam while rejecting the extreme Sufi doctrine of annihilation of the individual, page 78.
- Kharaj A land-tax on both Muslims and non-Muslims, as well as a poll-tax (Kharaj al Jizyah) on non-Muslims, page 71.
- Khilafat ir Rashidun The caliphate of the four "right-minded" immediate successors to the Prophet Muhammad, namely, Abu Bakr, Umar, Uthman, and Ali, from 632 to 661 A.D. in Medina. This term does not refer to the individual caliphs, who succeeded the Prophet as Imams or Rulers, but rather to the vicegerency or viceregency of all men, i.e. to the power delegated by God to all men, under the leadership of the caliphs, to be His agent on earth, pages 71,88.

Kitab al Bai Book of Sales, a book of Fiqh interpreting the Shari'a principles and precedents in commercial law, page 37.

- Kuffar Sing. Kafir. Unbelievers or non-Muslims in general, who disobey God because they do not have a proper knowledge of Din and/or disobey Him in deeds. This ignorance or disobedience is known as Kufr. Kuffar include all those who were part of the primordial Islamic religion, but fell into error, the Jews, Christians, and Sabeans through anthropomorphism, the Mazdeans and Manichaeans through dualism, the Christians through tritheism, the Buddhists through sceptical denial of reason, and the Brahmins through rationalism and denial of revelation, page 9.
- Madhhab Pl. Madhahib. School of interpretation of the Shari'a; all recognized as legitimate though they differ in their views of the proper paths (Shari'a) to Din (religious knowledge) and from Din to practical life. In the early centuries of Islam, there were as many as 19 popular Madhahib, but only four Sunni and two Shi'a Madhahib have retained their popularity in recent centuries. The four are the Hanafite, Malikite, Shafi'ite, and Hanbalite, page 73.
- Mafasid Disutilities, a concept originated by al-Ghazali in the 4th Muslim century and developed by al-Shatibi in the 8th century to identify whatever impairs progress toward the goals which Islam sets in every individual life and for the entire Muslim community. The opposite of Masalih, page 18.
- Mal Physical property, as in 'Ibadat Maliya and Bait il Mal (House of Property or Finance Ministry), page 85.
- Maliki One of the four schools of Shari'a interpretation, founded by Malik Ibn Anas, known as Imam Malik, which emphasized tradition rather than reason, and especially the custom in second-century Medina, where Malik lived. This technique of interpretation is known as Istiṣlah and al Masalih al Mursalah (unrestricted interests) and has an element of pragmatic positivism, as distinguished from the Hanafite use of free-wheeling reason to arrive at equity, pages 35,74,77.
- Masakin One of the eight categories of recipients of Zakat, namely, the needy or indigent, who are not destitute but might be described as the "working poor," pages 73,97.

- Maşalih Utilities, the opposite of disutilities or Mafasid, which see, page 18.
- Muallat il Qulub Those Whose Hearts Are to be Inclined, i.e. one of the eight categories of Zakat recipients, referring originally to converts who were suffering as a result of their conversion to Islam, page 74.
- Muḍaraba A contract whereby a financier or silent partner provides capital to an entrepreneur or active partner in return for a share of the profits from the entrepreneurial use of the funds. Also known as Qiraḍ, pages 15,18,55,56.
- Muḍaraba banking The use of a two-tiered Muḍaraba, whereby the depositor performs the role of the financier, the "borrower" the role of the entrepreneur, and the bank plays both roles. The bank is active partner with the depositor, and silent partner with the borrower, pages 13,23,24,32,56,57,60,62-63,87.
- Muḍarib The active partner, working partner, or entrepreneur in a contract of Muḍaraba. Also known as Amil, Ḍarib, and even Muḡalliḍ, page 19.
- Mufti A philosopher of Islamic jurisprudence who issues Fatwas, which see, or legal opinions designed to advise the public, usually at the request of a party to a dispute, on how individuals or the community in general can best pursue the general purposes either explicit or implicit in the revealed law of Islam, pages 19,73.
- Muhaddith An expert practitioner in interpreting the various Hadiths or traditions recorded about the sayings, practices, and approvals through silence, of the Prophet Muhammad and his Companions.
- Mujaddid One who undertakes and carries out Tajdid, i.e. Islamic renewal, as contrasted with the Muḡallid, who supports Taqlid or Islamic reaction, page 30.
- Mujahid Pl. Mujahidin. One who carries out Jihad, which see, especially in armed combat.
- Mujtahid One who undertakes and carries out Ijtihad, which see.
- Mukus Sing. Ma'ks. An extra-Shari'a group of taxes levied under the Mamluks in 14th and 15th century Egypt so onerously that they led to economic decadence and politico-religious revolt, page 72.

- Muqallid One who supports and practices Taqlid, which see, pages 26,30.
- Muqaradah A term originated by the people of Medina to refer to the institution of Muḍarabah, so called because it looks at the Muḍarabah contract in terms of the financier who surrenders (Qard) rights over his capital to the Muḍarib or entrepreneur, pages 19,23.
- Mushrik Polytheist; the worst kind of Kuffar or non-Muslims, as distinct from the best kind, i.e. the Dhimmis, page 9.
- Mutazillites Supporters of reason and revelation equally in ascertaining truth, and thereby separatists (from which the name derives) in their opposition to the Traditionists, led by ibn Hanbal, who distrusted the reliability of reason in ascertaining truth. They developed the system of rational theology, known as Kalam, in defense of Islam against the Greek secular rationalists. The Mutazillites emphasized the unity of God and therefore denied: 1) the attributes of God; 2) the eternity of the Kor'an; and 3) the literal interpretation of the Kor'an. They also emphasized the justice of God and therefore denied predestination and supported the early Qadarite concept of free will, page 6.
- Muzaki Payers of Zakat, page 71.
- Nafs The human soul, page 85.
- Nisab The level of wealth below which the possessor was exempt from the Zakat levy; this exemption limit varied among kinds of wealth, depending on the input of human labor and capital required to produce it, pages 73,75,76,98.
- Nawa'ib Supplementary taxes beyond Zakat levied to cover calamities and other emergencies in early Islam, page 71.
- Qadi A judge in a Shari'a court, page 34.
- Qard Surrendering, refers to the surrender of the financier's capital to the entrepreneur in the institution of Muḍaraba, and forms the basis of the term Qiraḍ, which is an Arabic synonym for Muḍaraba, page 19.

Qard i Hasan    Loan without interest, page 32.

Qirad        Synonym for Muḍaraba, page 19, viewing the contract from the viewpoint of the financier who surrenders (Qard) his capital to the Muḍarib or entrepreneur, page 19.

Qiyas        Analogy, from the root word meaning "measuring," is one of the four Usūl or sources of Islamic law. These consist of the true sources, i.e. the Kor'an and the Sunna, and the derived sources, i.e. Ijma and Qiyas. Qiyas was admitted as a fourth source only after Shafi'i (who died 204 years after the Hegira to Medina) rejected both the unrestricted reason or Istiḥsan of Abu Hanifa (died A.H. 150) and the pragmatic custom or Istiṣlah of Shafi'i's mentor, Malik (died A.H. 179). Shafi'i taught that exact precedents in the original sources for application to current issues and cases are not necessary and that exerting oneself (Ijtihad) through the use of one's own reasoning power to distinguish right from wrong is legitimate provided that it is based on analogy with statements and events in the Kor'an and Sunna. The prerequisites for analogy (Qiyas) so that it does not degenerate into mere personal opinion (Ra'y) are: 1) although there is no clear text as a case in point, the intent or "cause" of the judgement in the original text must be apparent and complete; 2) the moral issue or intent must be identical in both the original subject and the subject of analogy, i.e. merely superficial similarities in attributes are not sufficient; and 3) the rule in the original case must be applicable generally and not restricted to unique circumstances. Although Shafi'i restricted Ijtihad by these prerequisites, the universal Ijma soon came to recognize the use of Ijtihad to apply the holistic intent of the entire body of Shari'a, a task, however, for which few Muslims would be qualified, page 78.

Rabb        Lord, referring to Allah, and never to religious leaders, such as the Jewish Rabbis, page 108.

Ramadan    The ninth month of the Islamic calendar during which Muslims fast from dawn to dusk in commemoration of the beginning of the revelations to the Prophet Muhammad. This is the major occasion to carry out the injunction of Sawm or fasting as one of the five pillars of the faith in order to discipline oneself for more complete submission (Islam) to Allah, page 72.

Ra'y

Unrestricted reason in the form of personal opinion, not following the restrictive techniques of analogy (Qiyas) or even of logical inference (Istidlal). Often used to denote extremism in the use of the Hanafite technique of Istihsan or rational equity in determining right from wrong, page 36.

Riba

The attitude of taking instead of giving (Infaq) in all one's relationships with God and with one's fellow men. More specifically, Riba is the act of violating both elements of Tawhid, namely, by claiming an unjust share in natural resources created by God, and by claiming an unjustly large share of benefits or an unjustly small share of the risks in any business transaction. Still more specifically, Riba is charging interest, under the three conditions that there be: 1) a surplus in the amount owed over the principal amount of the loan; 2) predetermination of the amount of surplus to be paid; and 3) the designation of fixed times of payment to determine the amount of the surplus due. In pre-Islamic Arabia Riba, which etymologically means both surplus and increase, referred to the practice whereby a lender increased and often doubled the amount of money owed, as a penalty for late payment of a debt due to him, denoting therefore both the surplus and the increase in this surplus, page 15,23,56,57,105,106.

Riba al Fadl

A special kind of Riba common in pre-Islamic Arabia, translated as "interest in barter," whereby commodities of the same kind are exchanged in varying quantities, so that one party borrows a commodity and repays a larger amount of the same commodity as an equivalent of principal plus interest, page 16.

Riba Nasia

The pre-Islamic practice of charging both interest on a loan and a penalty of additional interest for late payment of the original principal and interest, page 15.

Rububiyya

Divinity of Allah, the recognition of which is the first of the two elements of Tawhid, whereby every man individually and all men collectively have an obligation or trusteeship duty (Khalafa) to actualize the will of Allah through the physical and moral development of both man and his environment, pages 84, 108.

- Sadaqat Voluntary charity, sometimes collected by the government as a service. Sadaqat is also used to refer to all charity, both obligatory (Zakat) and voluntary, and in this sense Sadaqat is similar to the broader term Infaq, page 70.
- Sadaqat il Fitr A synonym for Zakat or obligatory charity, collected by the government to assure objectivity in determining a person's true surplus wealth and in determining the recipients' true need, page 70.
- Sadaqat it-Tatu'wa Voluntary charity, a term used to distinguish Sadaqat in its restricted sense and Sadaqat in its broader sense of both voluntary and obligatory charity, page 70.
- Sahib il Nisab The Musaki or payers of Zakat, literally the heads of households who have wealth in excess of the minimum exemption level (Nisab). In Pakistan this term refers to those who are obligated to pay Zakat, regardless of whether their wealth in any given category exceeds the Shari'a-designated Nisab levels, page 79.
- Sahukar A person who commits Riba generally, and more specifically who charges interest in money transactions, page 17.
- Sajdah The prostration in public prayer, Salah, performed twice in each set of prayers (Ruku), designed to educate every Muslim in his dependence on the all-sovereign Allah and in his equality with every other Muslim in the sight of Allah, page 85.
- Salah Also spelled Salat. Public prayer in Islam, which is one of the five pillars of the faith (Shahada or profession of the creed; Salah; Sawm or fasting, especially in Ramadan; Hajj or pilgrimage to Mecca; and Zakat or almsgiving) deemed to be the essential minimum of outward acts to assure that every man inwardly will become and remain a sincere and practicing Muslim, pages 55,84,85,106-107,109.
- Shafi'i One of the four schools of Islamic jurisprudence, which introduced the concept of analogy (Qiyas) as a compromise between the free-thinking Istihsan of the Hanafite school and the pragmatic custom (Istihsan) of the Malikite school; later opposed by Ahmad ibn Hanbal, who died in A.H. 241, i.e. 37 years after Muhammad ibn Idris al-Shafi'i, and opposed even al-Shafi'i's carefully circumscribed use of rational analysis as a source of divine law, page 77.

- Shahada The recitation of the Islamic creed, one of the five pillars of the faith, which consists only of the two sentences "I believe that there are no gods besides Allah; I believe that Muhammad is His Prophet." This expresses submission (Islam) to the will of Allah as revealed to the last prophet in the Kor'an and interpreted by him in the Sunna, which together form the only direct sources of the Shari'a or Islamic law, page 84.
- Sharakat The concept of productivity sharing, usually in a joint venture or stock company, page 98.
- Shari'a The road or path to the will of Allah and from His truth to the distinction between right and wrong in one's daily actions. This path consists of the direct revelations by Allah in the Kor'an and the interpretations of it by Muhammad, which together form the only direct sources of Islamic law. The Shari'a or law occupies an important place in Islamic thought because God has revealed to man only His law through the prophets (Abraham, Moses, Jesus, Muhammad and others) and has not revealed His own nature, so that theological speculation is considered much less profitable than legal analysis. The Shari'a or Islamic law is a purposive institution designed to provide strategic guidance in changing the human community and the human individual toward the Islamic ideal, rather than merely to provide stability of expectations and a dispute-settling mechanism as do most other systems of law. Therefore the task and the focus of creativity in Islamic law is not to induce principles from particular cases, as it would be in the West, but rather to deduce particular applications for each jurist's time and place from the general and eternal principles in the revealed Kor'an, the explanatory Hadith (mainly oral communications of the Prophet), and the evidentiary Sunna (mainly the usage or practice of the early Muslim community), pages 6,12,16,18,25,27,40-42,56,73,78,84,88,108.
- Shirk Ascribing divinity to anyone or anything else besides Allah, as well as a willed dissociation from Allah of what is His own; therefore idolatry or substitute worship, associationism, heinous pluralism, an alternative love denying the divinity (Rububiyyah) of God and His sovereignty over all creation, including man. This is the cardinal sin of Islam, just as denying the Holy Spirit or third person of the Trinity is the unforgiveable sin in Christianity, pages 85,108.

- Shirkah An unlimited partnership, whereby both parties share equally and without limit in all profits and losses in proportion to their contribution of value (capital or labor and entrepreneurship) to the business undertaking. This is distinguished therefore from Muḍaraba, which protects both parties from total liability; the financier or capitalist because losses in the joint venture beyond the amount of the capital invested are borne by the entrepreneur and not by the financier's other assets; and the entrepreneur because his assets cannot be attached by any of the venture's creditors until after the losses have been deducted from and exhausted the contributed capital, pages 21,24.
- Shirkat Inan Unlimited partnership, as in Shirkah, page 20.
- Shura Consultation by the ruler with representatives of the special interest groups in society, accomplished easily through the weekly or daily audience (Majlis) in simple societies, but perhaps only through some more formal mechanisms, such as parliaments, in modern societies where the government attempts to do what people used to do for themselves. Shura, by whatever means, is an absolute requirement for political legitimacy in the Islamic state, just as Ijma is the requirement for authority in the Shari'a, page 28.
- Siyasa Administrative law, known in the Ottoman Empire, which developed it most highly, as Qanun (Greek for regulation), i.e. the exact opposite of Canon law in the West. Since all law in Islam is revealed by God, Siyasa was the administrative power of the ruler not to legislate but to enact regulations carrying out the Shari'a and filling in any "gaps." This power extended to both the executive and judicial spheres and was often called Siyasa Shari'ya in order to emphasize that it had to be exercised within the limits allowed to it by the Shari'a. Siyasa, however, in some centuries and places nearly replaced the Shari'a altogether except in family law, pages 6,73,79.
- Sufism Mysticism, which has always been important in Muslim societies, but often went to extremes in reaction to the excessive legalism that grew like a cancer under the influence of Taqlid (resort to external authority without regard for the moral principles that first generated the authority). Muhammad and all the great Islamic intellectuals were at least to some extent mystics, but not until al Ghazali in the fifth Muslim century was Sufism integrated into the Islam approved by the conservative 'Ulama. Subsequent popular religious movements cultivated their own

religious leaders or 'saints' under the banner of Sufism and fostered political resistance or revolution against established authority in most areas of the Middle East, but especially in North Africa and Iran, page 6.

Suftadja The principle of even exchange, which is basic to contract law in the Shari'a. Deliberate failure to implement Suftadja is an act of injustice, and failure adequately to specify the objects and terms of the contract creates a potential for injustice, pages 14,16.

Tajdid The movement of renewal or rebirth in Islam, which is a moral response, occurring cyclically, to the challenge of moral decline. Tajdid is the comprehensive and holistic application of a civilization's original values in order either to fill a vacuum, or to counter internal perversions (such as extreme, nihilistic Sufism), or to displace any challenging foreign values. This has been the dominant response to challenges to justice, either from within the Middle East or from without, since the first Mujaddid, the Prophet Muhammad, and even before him to the times of the first prophet, Abraham. Tajdid may be defined as Islamic fundamentalism, but it is so in a very positive, creative way, and it is the opposite of Taqlid, which is a fundamentalism of negative reaction, pp. 6-7,26,30,42,53,58,82,83,105,110

Taqlid A negative, reactionary retreat into the externals of the past, typified by those who tried to "close the doors to Ijtihad" during the past few centuries and especially in much of Iran today. This response to a perceived challenge to justice is a mechanical interpretation of past authority without reference to the values that originally gave rise to this authority or to any new values that may challenge it. This is really a failure to respond to change and thus is a failure to cope. Although Taqlid is generally passive in its response, it can degenerate or explode into revolutionary hatred of all change and all agents of change, especially if these changes are inspired by a foreign culture, pages 5,26,30,58.

Tawhid Most elementally, Tawhid is belief in the Oneness of God, which is the central tenet of Islam. Tawhid is not merely an affirmation that Allah is the sole Creator of the universe, which many non-Muslims believe, or a dogma in opposition to the Christian doctrine of the Trinity. Tawhid is a philosophy of life composed of two elements, from which derive the entire Shari'a (Islamic law) and the entire Kalam (Islamic theology).

The first element is the principle that Rububiyyah (divinity) in an Islamic society is only for Allah, which means that every man and all men are subject to the total sovereignty of God over all of creation and should direct their lives to act as vicegerents or representatives of God in actualizing His will for the more perfect temporal and spiritual development of all that God has created, including man. The second element derives from the first and consists in the equality of all men in their relationship to God, from which stems the strong values of brotherhood and egalitarianism in Islam. These two basic principles of the single doctrine of Tawhid serve as points of origin for the elaboration of a hierarchy of purposes, goals, objectives, and courses of action, which form the substance of Islamic economics and of every other branch of Islamic studies. The doctrine of Tawhid can be carried to mystic extremes, as indeed the modern Iranian intellectual, Shari'ati, may have done, which would turn Tawhid into the end of all action rather than its point of origin, pages 14,53,73,83,84,86,102,106,107.

Tazkiyah Purification, an important obligation in Islam preparatory to public acts of submission to Allah and to interior devotion, as well as to the enjoyment of material wealth; the first purpose of Zakat and Sadaqat, which come from the same root, zki, page 85.

Thawra Revolution, page 5.

'Ulama Scholars with formal training in both the Kalam and Shari'a, who exercise leadership and earned authority deriving from their personal excellence, since there is no clergy or priesthood in Islam, pages 72,73,87,94.

Umma The concept of community in Islamic political science, whereby the political life of every man may be viewed as a series of concentric rings of loyalty toward the fellow men around him, or as a series of ever-broadening identity affiliations or solidarity groups. This community is held together at whatever level, family, tribe, nation, by a collective awareness (Asabiyyah) of a common past, common values, and a common future. The lower levels of umma serve as building blocks for the next higher levels, rather than as competitors for an exclusive sovereignty or as contenders for a monopoly of loyalties. The Prophet Muhammad stressed the need to sublimate the loyalties of the Arabian tribe into a higher loyalty to an Umma Islamiya, page 109.

- Ushr Tithe, from the Arabic 'Ashara (ten), levied on agricultural produce as one of several taxes in early Islam. Although the other taxes became separated from Zakat, the Ushr tax of 10% on rainfed crops and 5% on irrigated crops has always remained in concept part of the Zakat levy, pages 72,76.
- Usul Roots, referring to the four sources of the Shari'a, namely: the Kor'an or revealed word of Allah; the Sunna or usage of the early Muslim community as well as the oral Hadith or communications of the Prophet; Ijma or consensus of the Muslim community, usually as expressed by the 'Ulama; and Qiyas or analogical reasoning, page 36.
- Wabnus Sabil One of the eight categories of Zakat recipients permitted in the Shari'a, specifically the Wayfarers, who are travelers temporarily without money and even political and religious refugees, page 74a.
- Wali al-Amr Guardian or administrator of wealth, page 57.
- Zakat A compulsory levy by the government of an Islamic state to guarantee that those in society with an abundance of wealth will share their abundance with the needy. Zakat is not a tax to support the government but a charity collected obligatorily by the government in order to enforce an objective standard of "abundance" in the collection of Zakat funds and of "need" in their disbursement. Zakat has six discrete purposes within the overall concept of Tawhid: 1) submission to God; 2) economic redistributive justice; 3) economic allocative justice; 4) social/political justice; 5) economic growth; and 6) education, pages 23,50,55,58,70,76,78,83,85,86, 107,109.
- Zakat as a tool of fiscal policy Zakat, Muḍaraba banking, and Muḍaraba insurance are the three major tools of Islamic economics, which in turn is the major sub-discipline within the Shari'a or system of Islamic law. In an Islamic state, Zakat is an "irreducible minimum ingredient" of government fiscal policy, serving not so much to solve societal problems by itself as to form the "leading sector" of broader governmental priorities. As such, its impact is mainly directional and normative. It is an instrument to develop and establish Islamic goals, pages 13,78,91,95-99.
- Zakat il Fitr A term to designate obligatory Zakat and distinguish it from voluntary Sadaqat (Sadaqat it-Tatu'wa); Sadaqat il Fitr also means obligatory Zakat, page 70.

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