

# The Concept of the Islamic Economic System

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## **INTRODUCTION:**

The Islamic Resurgence movement has led to a call for Islamizing society and polity in several Muslim states. The declared rationale for this call is the view set forth by several Islamic intellectuals, theologians and statesmen that Islam is not merely a system of individual devotion and piety calculated to bring about spiritual salvation in life hereafter, but rather a complete way of life, a blue print of the good life in its totality including politics and economics. The concrete contours and details of this map, so they say, ought to be adjusted to the ever changing human situation with the concurrence of competent *Ulema*. Nevertheless the total map must be firmly based upon the Quran and the example of the Prophet.

The advocates of Islamic Resurgence hold that the Muslim liberals of the mid-twentieth century merely imitated Christian liberalism which viewed religion merely as a personal relationship between man and God without regulating human political and economic concerns. The advocates of Islamization hold that Liberalism, Socialism and Communism have all failed to cure human ills in the modern age and that the only hope for mankind lies in a return to the Islamic or Quranic system of economics and politics.

In the sphere of economics, the main thrust of the Islamic Resurgence movement is the literal implementation of the Quranic prohibition of usury/interest which is seen to be the root evil. It is claimed that '*zakaat*' (the

Islamic wealth tax) and the Quranic law of inheritance would suffice in an interest-free society to cure all economic problems. *Zakaat*, as a 2.5% tax on net wealth at the end of the financial year, was made a statutory tax about five years ago in Pakistan and is being regularly collected by the state directly from banks. In the case of all *Sunni* Muslims (who are the dominant majority in Pakistan) payment of bank interest on deposits and charging of interest on bank loans for industrial commercial purposes have been totally banned since early 1985, though the ban does not yet apply to foreign transactions. A new scheme of Islamic profit/loss sharing by bank depositors has recently been started for promoting investment and economic growth without the lever of interest. It is expected that these innovations would not adversely affect the rate of growth or health of the economy. On the other hand, the abolition of interest is expected to promote social justice and general welfare and to remove several social or moral evils inseparable from various non-Islamic politics.

Whatever be the truth of the above claims, the fact is that no attempt has been made, to my knowledge, to present a historical and systematic theoretical analysis of 'interest' or an integrated theory of general economics to show how a totally interest-free world economy would or could work in an admittedly imperfect and 'imperfect able' world.

In what follows I shall analyze the basic concept of an Islamic economic system, as an integral part of the Islamic faith. I shall then examine the basic thesis that the abolition of interest is the root remedy for human socio-economic ills.

### **The Concept of an Islamic Economic System**

I begin with the Quran. Quranic verses dealing with fiscal or economic matters are (with literally two or three exceptions) in the nature of moral exhortations to do the right or the customary and not specific injunctions implying or even pointing to any 'economic system'. Thus, for instance, Quranic verses

repeatedly enjoin believers to spend in the way of God, to help the needy, the traveller and the orphan, to avoid extravagance, pomp, avarice and the hoarding of wealth, to be just in weighing and measuring, to fulfill promises and contracts, to avoid bribery and cheating, to be lenient to the debtor, to give honest testimony even when it goes against one's kin, and so on. The only verses which state not mere ethical norms but rather economic rules or regulations are the verses dealing with *zakaat* (tax on surplus wealth) and *riba* (usury/interest).

*Establish worship, pay the poor-due, and bow your heads with those who bow (in worship). 2:43.*

*Those who swallow usury cannot rise up save as he ariseth whom the devil hath/prostrated by (his) -touch. That is because they say: Trade is just like usury; whereas Allah permitteth trading and forbiddeth usury. He unto whom an admonition from his Lord cometh and (he) refraineth (in obedience thereto), he shall keep (the profits of) that which is past and his affair (henceforth) is with Allah. As for him who returneth (to usury)--such 'are rightful owners of the Fire. They will abide therein.2:75 .*

*O ye who believe! Devour not usury, doubling and quadrupling (the sum lent). Observe your duty to Allah, that ye may be successful. 3:130*

*And of their taking usury when they were forbidden it, and of their devouring people's wealth by false pretences: We have prepared for those of them who disbelieve a painful doom. 4:161*

*That which ye give in usury in order that it may increase on (other) people's property hath no increase with Allah; but that which ye give in charity, seeking Allah's countenance, hath increase manifold. 30:39.*

(The above translations are from Pickthall's standard work, *The Meaning of the Glorious Koran*). The Quran nowhere gives any further details, as it does in the case of some other matters--inheritance, divorce, remarriage, evidence and even the proper procedure of oaths.

It may be thought that since the Quran prohibits usury/interest and implicit obedience to the Quran (the infallible word of God) is obligatory on the believer, the Muslim believer has no option except totally to abjure interest. This line of thinking ignores the methodological principle that prior to drawing any conclusion with regard to 'interest', the exact meaning of the Arabic term '*riba*' used in the Quran should be determined, instead of mechanically equating it with the English word, 'interest'. At times words of a living language undergo great changes in their functional meaning and practical significance due to various factors.

Full investigation into the socio-economic conditions of the then Arab society and the present conditions plus reasoned interpretation of the Quranic text (rather than simplistic literal obedience to the Quran or the Prophet) is the correct approach, not only for the economic historian or social scientist, but also for the committed Muslim drawing inspiration from the Quran and the example of the Prophet.

The advocates of literal obedience to the Quran also ignore (rather much too readily) the historical fact that the Prophet and the pious Caliphs always resorted to juristic reflection on or interpretation of the Quranic text. This naturally led to the admission of qualifications, subtle distinctions in the understanding of the operative or directive meaning of the plain literal texts. For instance, the seemingly categorical Quranic injunction that 'the hands of the thief be cut off' was never applied unconditionally on pain of disobeying the word of God.<sup>1</sup>

The making of relevant distinctions and qualifications is, therefore, also called for in the context of *riba*. This Arabic word literally means increase or growth of any entity—physical, biological or spiritual. Thus the Quran refers to '*riba*' of spiritual merit (*sawaab*) or of punishment (*azaab*). In the economic sphere *riba* means the excess sum demanded by the lender over and above the principal amount lent. Though 10,000 as a lump sum, at anyone point of time, is arithmetically identical with the same amount spread over several years, yet, a consolidated sum has power to purchase an animal, land or tools which augment the wealth of the user, while the same sum spread over a long period of time lacks this purchasing power. *Riba* or usury, thus, has been a universal practice in recorded history. At the same time it has been universally disapproved of, since, in general, lenders' demands always tend to be excessive or exploitative.<sup>2</sup>

The demand of compound interest makes the situation much worse. Moreover, in ancient times the contract of usury also provided that failure to return the agreed sum in time would entail bonded labour by the borrower from 3 to 7 years. The concept and practice of usury in the ancient and middle ages was, thus, closely tied up with the institution of a form of temporary slavery. This aspect of usury was morally most repugnant in the case of distress loans. The Jewish sense of group solidarity led them strongly to disapprove of usury among themselves, though charging usury from non-Jews was permissible. Subsequently, both Christianity and Islam applied the prohibition to all human beings. This was an advance, upon the Jewish ethos. However, both Christian and Islamic jurists ignored the crucial distinction between usury (in the above mentioned sense) and interest in the modern sense of the term. If we take the expression, 'Islamic economic system' to mean a normative system which is an essential part of the Islamic faith and is permanently binding upon all good Muslims, no such system is found in the Quran or the *Sunnah*. Nor any such

system can be deduced (logically) or inferred (analytically or analogically) from the Quran and the *Sunnat*. The actual claim by a person, that a particular system is the Islamic norm, is nothing more than a reference to Islamic practice in history, or his opinion how the Islamic system should be. To put it in other words, all such claims are, at bottom, a recommendation that the stated system be accepted as the Islamic system.<sup>3</sup>

What is being called 'the Islamic economic/agrarian system is, indeed, a slow growth which took place in only a marginal sense in the lifetime of the Prophet, and was gradually developed, first by Caliph Omar, and subsequently by other jurists who followed. The process of development spread over two centuries.

The nascent Islamic economic system freely borrowed (quite understandably) from the economic culture of pre-Islamic times. Thus, '*jizya*', (the tax on protected non-Muslim citizens of the Islamic state) was a medieval Iranian practice going back to the Jews in antiquity. Sovereign Muslim rulers (Sultans) in Central Asia, India and elsewhere adjusted and adapted the economic and political ideas and practices of the Umayyad and Abbasid Caliphs to suit local and ever changing conditions. As and when the orthodox *ulema* tried to arrest this practice, tension and conflict developed between the king and the priest, or the state and the church. With a few exceptions, the Indian Muslim rulers or sultans (even much before the radical and liberal Akbar) asserted the supremacy of the state in worldly matters and consistently refused to treat the opinions and advice of the *ulema* in such matters as binding upon the state. The so-called Islamic economic/agrarian system, therefore, has never enjoyed the sanctity and binding power as the Islamic precept system relating to prayers, fasting, zakaat and the Quranic laws relating to marriage, divorce and inheritance.

## **Islamic Economics**

Does the expression 'Islamic Economics' have any significance apart from, (a) economic history or geography of the Muslim world, or (b) what Muslim social scientists have contributed to Economics? It might be thought that 'Islamic Economics' is also a theoretical social science that deals with the best method of maximizing material wealth within the parameters of Islam. If so, the scope of 'Islamic Economics' would go beyond the mere economic history or geography of the Muslim believers. According to this concept the social economic polity of a truly Muslim state must reflect and promote the basic Islamic conception of the good life in all its multifarious aspects. However, as soon as we try to spell out the concrete socio-economic features demanded by 'Islamic Economics' we find ourselves faced with conflicting possibilities of choice. And we are thrown back upon our own common sense, economic theory and actual experience in order to clinch various issues.

This difficulty arises because Islamic values--equality, fraternity, generosity, charity, sympathy, justice, compassion and so on--are all abstract concepts. The moment we try to realize them in the framework of laws and a concrete polity, a plurality of social and economic blueprints become candidates for the title 'Islamic' as each claims to be the only true expression of Islam. The same difficulty (to a lesser degree) arises in connection with the two or three specific Quranic economic injunctions mentioned previously.

Thus, 'Islamic Economics', in the sense of prescriptive economic theory, lands Muslims into controversies, which, by their very nature, cannot be solved on the basis of the Quran or the *Sunnah alone* without recourse to independent logical thinking and ethical reflection. In the final analysis, therefore, the term 'Islamic Economics' tends to mislead us into seeking and projecting 'Islamic truths' of economics, or saying that Islam demands the acceptance or rejection of any particular economic system as part of one's faith. However, 'Islamic economics' in the purely descriptive sense as a systematic area study of the economic history of Muslim society or societies or the economic ideas and perspectives

of Muslim social thinkers remains a valuable area of study.

Due to semantic confusions several Islamic social scientists, writers and statesmen now find themselves disputing not only with 'secular' economists but among themselves about the 'identity of the true Islamic system of economics. Paradoxically, Islamic prescriptions and injunctions (that are believed to be Divinely imposed and meant to function as infallible standard for judging man-made systems of thought) itself becomes a matter of unending debate. One, therefore, cannot help concluding that the directive thrust of the Quran lies in spiritual beliefs and moral exhortation rather than in the sphere of economic legislation. Anyone who claims that the Quran prescribes any particular economic philosophy or system is as off the mark as one who claims that the Quran supports or affirms any particular theory of Astronomy, Physics or Biology. No system could possibly claim a Quranic mandate as in case of laws of inheritance, divorce, prohibited degrees of marriage etc which are, specifically, contained in the Quran. No positive economic system of Islam could be anything more than a rough logical construction based upon two or three economic injunctions viewed as axioms by the believer.

There can be, I submit, no Islamic truths of economics any more than there could be Islamic laws of Astronomy, Physics, Chemistry, Biology, or Medicine.<sup>5</sup> Economics must be treated as an empirical social science governed by the standard scientific method appropriate to its nature, scope and limits. As a science all its theories, conceptual models, mathematical projections and predictions of mass behaviour and social-economic implications of fiscal policies will have to be empirically tested for their validity or truth. All pre-conceived notions, assumptions, untested hypotheses, will hamper the economist's task of analyzing the motives, structure and implications of general economic behaviour.

The above task implies a neutral phenomenological analysis of economic concepts, practices and systems (just as a natural scientist analyses natural phenomena) rather than the justification of any pre-rational conviction concerning any particular economic concept or practice including usury/interest. I submit even a committed Muslim economist *qua* social scientist, should do the same instead of assuming that interest is the root of all economic or social evils.

If I, as a Muslim, be inwardly convinced that interest must be evil (since the Quran prohibits it), but do not temporarily suspend this belief while rationally examining the issue, my judgment would not be impartial but rather 'weighted' against interest. Even when I consciously aim to find out the truth rather than to defend any particular view, my perception of the function and utility of interest would be colored by my antecedent beliefs. Likewise, if I have been conditioned by my milieu to hold all religion or pre-modern ideas as infantile myths or as superstitions, I may miss out on some crucially relevant consideration or aspect of the issue. Suspension of belief is, thus, indispensable for a truly detached and balanced approach. To the extent I fail in doing so I shall become selective—noting or emphasizing some features but missing out or ignoring others, thereby confirming my initial slant. However, if I could empty or neutralize my ideological affiliations and predilections or 'ideological vested interests' as it were (as far as humanly possible), I would maximize the clarity of my thoughts and grasp the complex contours of the issues concerned.

I am not suggesting that the social scientist ought to or actually can do away with assumptions about human nature or with moral values. In fact, the committed Muslim ought not, and never can lightly treat the Quranic prohibition against 'riba'. All I say is that while analyzing and appraising economic concepts and practices, the social scientist must suspend or put in 'brackets' (as the German thinker, Husserl says) all one's preconceived notions and endeavour to discover the structures and interconnections of events or entities and one's own

authentic value judgments. If this is not done, one is very likely to be advancing bad reasons for justifying what one takes to be the one and only right interpretation of Scripture. When this happens, all theoretical arguments turn into self-deception.<sup>4</sup>

Suspension of belief for the duration of the enquiry does not imply rejecting the antecedent belief which might, possibly, even get confirmed as a result of the enquiry. If so, no problem of the conflict between faith and reason would arise. If, however, any conflict does arise the individual remains free to make a well considered choice. If one chooses the verdict of faith he would not be inclined to 'rationalize' (in the pejorative sense), but merely claim that this course gives him a 'total satisfaction' which he values more highly than mere 'rational satisfaction'. And this would be a very valid stand to take, provided, of course, his sense of 'total satisfaction' is not tainted with fear or doubts. There is nothing objectionable in opting for faith after passing through the discipline of Husserl's 'epoche'. Likewise, there is nothing wrong if the person goes 'where the argument leads him' via the method of Socrates after passing through a struggle between the pull of faith and the pull of reason, provided the final choice is the fruit of authentic freedom rather than of fear, greed, or some hidden motive

The fear of loss of traditional faith should not stand in the way of the person's quest for authentic being-- his inner journey to reach 'the truth of his being' rather than 'the truth of his milieu'. Even if the believer loses his traditional faith or rather its traditional interpretation, this is not necessarily to lose his valuational roots or his spiritual identity, unless, of course, his free enquiry brings about a total rejection of his initial beliefs and values. Should this happen the honest seeker must have passed through a profound inner struggle. And the experience of deep spiritual unrest and honest enquiry yields the pure gold of human authenticity in the crucible of spiritual suffering.

In the final analysis, authenticity or authentic being, irrespective of its contents, is the highest possible mode of human existence. This authentic being is attainable, both by the autonomous philosopher and by the man of faith who has reached the condition of 'blessedness' in the spiritual sense. In practice, however, authentic being appears to be more difficult to achieve at the religious level, when one's religious beliefs or values collide with one's inner rational choices, and thus lead to inner tensions. However, the autonomous philosopher cannot claim any superiority of status over the religious person who freely and authentically submits to an external Authority, provided their degree of authenticity be the same.

The outcome of the above analysis is that Husserl's method of 'epoche' is pre-eminently desirable, even if one loses one's traditional religious beliefs, but attains and retains the condition of authenticity which is functionally akin to spirituality. It is all to the good if the individual becomes aware of his hidden assumptions and his heightened self knowledge reveals his existential depths and he becomes a more fully integrated person than he was as a 'mass-member' of some 'human herd' or other, no matter what it might be.

### **The Concept of an Interest-free Economy:**

Interest has continued to flourish in the human family though the great historical religions disapprove of it in varying ways. Is this state of affairs merely another instance of the the distance between the ideal and the real, or is there some specific social need that interest or usury served and still serves. If so, how will that need be served if an Islamic Society abolishes interest? Again, how or in what precise way is an interest-free society more desirable than an interest-based society? The answer to these important questions should not be given by

way of justifying the Quran or the *Sunnah* but must be based on honest and searching reflection in the light of reliable factual investigation.

The liberal Muslim intellectuals and statesmen of the previous century, among whom S. Khuda Bakhsh occupies an honoured place, did indeed, attempt this important task. They made a distinction between (a) usury and interest and (b) different types of loans--distress loans, consumption loans and development loans for various purposes. They came to the conclusion that accepting bank interest on deposits and commercial interest were quite permissible. However, charging interest on distress loans or even on consumption loans was un-Islamic.

Accepting bank interest on deposits is very different from charging interest on loans advanced to others. The depositor places his savings at the disposal of the bank which invests them either in the form of loans or purchase of shares in sound industrial concerns etc. Thus, the interest given by banks is, in reality, a slice of the profits which accrue to them on their investments. Interest-bearing deposits in banks or companies promote investment of idle money for the dual purpose of increasing the owner's wealth without diverting him from his actual vocation as also promoting general material prosperity through increased production and employment of the work force.

The Muslim liberals were correct in their basic approach, but their historical and analytical discussion of the nature and function of interest was too inadequate to convince traditional conservative opinion on such matters. They were unable to provide a rationale satisfactory to both reason and Islamic faith. Perhaps this explains how and why the economic content of the contemporary movement of Islamic Resurgence has gained considerable vogue in several Muslim countries. To this theme we now turn.

To my mind, most Islamic economists who regard interest as the root of all economic ills start with three unchecked assumptions which are very far from being self-evident to a dispassionate analyst. The assumptions are: (a) there is no difference between usury and interest so that the Quranic prohibition of usury implies the prohibition of interest; (b) the unearned income or gain from a sleeping partnership is morally right, while unearned gain in the form of interest is morally wrong because of risk 'being present in the first case and absent in the second; and (c) the abolition of interest would not adversely affect economic activity and growth in general, but rather purge it of social evils. Let us now examine the above assumptions in some detail.

(a) Usury, in the ancient and medieval periods, was a charge upon all types of loans including distress loans contracted even by the poorest and weakest sections of society. Avaricious money lenders did not reduce exorbitant usury rates even for distress loans, to say nothing of waiving the interest out of sympathy or compassion. In this regard there is no difference between usury and interest. Yet, it would be quite fallacious to equate the two for the following reason. The rate of usury was fixed on the model of biological reproduction or agricultural growth which follows geometrical proportions, while interest, in the modern sense, is calculated on the basis of low arithmetical proportion. The difference between the two models of growth is so enormous that to equate usury with interest becomes like equating the domestic cat with the tiger. The model of biological growth for usury was suggested (quite naturally and understandably) by the average rate of reproductive growth of domesticated animals or familiar agricultural crops, namely, approximately 400% per annum. However, modern interest rates are deliberately kept, relatively speaking, very low in appreciation of the great role of planning and skill of entrepreneur in production and the generation of profit. In other words, in pre-modern times the owner of wealth tended to over-value his own role at the expense of the merchant or industrialist, and this approach

got reflected in the high rates of usury whose model was the rate of biological reproduction or agricultural growth. The biological model was quite understandable in an age when theoretical economics, social science and militant class consciousness were non-existent and the manufacturer or artisan had to borrow money in what may be termed as a 'usurer's market'. No exception was made in the case of distress or consumption loans, whose purpose was obviously quite other than increasing one's wealth. This state of affairs led to the exploitation of the poor or the needy, specially, when non-payment of borrowed amount attracted the penalty of bonded labour.

Interest in the modern sense, however, is computed as a function of the generally viable rate of profit in a given society. This approach has, considerably, pushed down interest rates in the modern age. Furthermore, the law prohibits penal bonded labour if the debtor be genuinely unable to discharge his commitments. Interest in the modern sense is, thus, quite different from usury. The assumption of their structural and functional identity breaks down in the light of historical and analytical scrutiny. The debate among Islamic economists whether insurance involves gambling (which Islam prohibits) is very relevant for correctly interpreting the Quranic prohibition of *riba*.

Insurance finds no mention in Islamic jurisprudence, while gambling and games of chance are prohibited. Since insurance is definitely linked with the workings of chance, the principle of analogical reasoning (*qeyaas*) led most jurists to conclude that Islam also prohibited insurance. However, many modern Islamic jurists now permit insurance. They make (rightly) a distinction between the function of gambling and the function of insurance, and hold that the function of gambling is momentary thrill (without giving anything in return to society) the function of insurance is protection against unhappy contingencies) and is, thus, pre-eminently desirable. Now why should not this

method of interpretation also be applied to the different types of loans and the issue of interest? While the charging of interest on a distress loan does involve exploiting human misery, does the same apply in the case of a loan for development of industry or commerce? Again, is not ancient and medieval usury involving exorbitantly high rates plus bonded labour functionally very different from interest used as a tool for stimulating the economy and protecting the legitimate interests of the investor, the entrepreneur and society as a whole?

Analytical discrimination and juristic reflection have, indeed always been practised by Muslim jurists no less than the Prophet and the pious Caliphs. The classical distinction between developed and virgin land, and permitting farming or sharecropping in the former case but prohibiting it in the case of the latter is a good example. The classical Islamic jurists applied the same principle when they waived the Quranic penalty for theft in several cases. Why should not the same approach be followed in the case of interest?

(b) We now come to the second assumption--unearned profit which is risk-bearing is equitable, but unearned interest which is devoid of risk is inequitable. Is there really any moral distinction between the risk-bearing nature of profit and the risk-free nature of interest over and above the purely economic difference that while profit is contingent and flexible, interest is pre-determined and fixed?

It may be thought that since interest is payable to the lender as an absolute claim irrespective of the economic health of the productive enterprise, this causes unmerited hardship to the producer if and when things go badly with his enterprise for no fault of his own. This unmerited suffering does not occur when the lender shares profit or loss in a partnership. There is an element of truth in this contention. But this moral factor becomes relevant only when the producer

is close to or actually reaches the state of economic breakdown or the rate of interest be so exorbitantly high as to make the profit almost nominal. Otherwise the factor of risk in a partnership or the absence of risk in the case of interest do not matter except when the rate of interest be so exorbitantly high as to cripple the debtor. In general, when a sleeping partner partakes of profits merely on the strength of supplying capital to the active partner, this appears to me to be as equitable or not as receiving a fixed but small and unconditional return for his monetary contribution to the enterprise.

Social justice is a highly complex goal having several aspects or coordinates. Justice certainly requires that the producer be protected against rough economic weather, but it also requires the reasonable protection of the supplier of capital. It appears that interest (viewed as a fixed charge paid by the producer) tends to motivate him to keep costs down and earn enough to be able to pay the cost of borrowing the capital, while cost-free capital tends to make the economic enterprise much too soft for the entrepreneur and to slow down the motor of economic growth. On the other hand, when the lender agrees to receiving a low rate of interest he pays a definite price for eliminating the factor of risk in the investment. Choosing a lower share for the sake of security and the elimination of risk does not involve any moral wrong. It is a measure of caution and the creditor's preference for secure returns and paying a price for this advantage. This appears to me as justified caution, and not evil. Charging interest (at high rates) becomes exploitation of the weak only when money lenders do so in the case of distress loans to the weaker sections of society. However, no inequity is involved when the supplier of capital demands a fixed (relatively low return) for his contribution to the complex productive process and foregoes all profits that accrue to the producer.

(c) Let us now examine the assumption that the charging of interest is an absolute evil and must be abolished in one stroke and that true Muslims must

aspire to do so without any 'ifs and buts', and that such abolition and the universal adoption of the 'Islamic model of partnership production' will make the world economy to prosper rather than cause a break-down.

The above assumption is not really warranted by our present state of knowledge and experience. Confirmation of this abstract forecast is a far cry at present. However, to my mind, careful non-ideological analysis does not warrant the optimism of Islamic economists in this regard. The reason is as follows: A sleeping partnership involves full liability without any security for the sleeping partner who supplies capital merely on the trust he places on the bona fides and competence of the managing partner. This, indeed, is the Islamic ideal (as also the ideal situation in general), but the distance between the ideal and the real is obvious. In case the partner be tempted for some reason or other to cheat or indulge in some sharp practices at the expense of the sleeping partner (such instances being too common in the human family to be ignored by any law-giver) the sleeping partner will ever remain at the mercy of the managing partner. It is precisely at this point that the economic function of interest appears in a sharp focus. No other economic mechanism appears to serve the same purpose as effectively as interest

It is true that if Islamic banks exercise proper vigilance both before and after investment this will act as a strong check upon the misuse of funds by managing partners. In any case human nature being what it is, the degree of security of investment, per force would depend upon the accuracy of the producer's balance sheet. Moreover auditing work would multiply enormously and thereby create scope for concealment and corruption. Now since international trade is unavoidable due to the inter-dependence of the human family as a whole interest bearing transactions between different countries, would continue. This would create anomalies and complications at different levels. Thus there does not appear to be any justification for permitting

unearned profits through Islamic partnerships but prohibiting interest per se. In fact, the slogan of profit/loss participation by Islamic banks in place of floating interest-bearing loans to the entrepreneurs is nothing but substituting the theologically acceptable term 'profit' in place of the theologically repugnant term 'interest' without any really meaningful change in economic theory or practice. However, the scheme of advancing interest-free distress or consumption loans at almost zero interest for specified purposes (*qarz-e-hasana*) is a definitely meaningful reform initiated by Islamic economists.

**The Language of Modern Economics:** Modern economists have defined interest in various ways putting forward several theories of interest. These theories are, at bottom, attempts to assimilate or reduce interest to some other concept such as profit, rent, price, cost, increment, reward and so on. As a student of philosophy it appears to me, that no theory which is purely reductive could ever provide a complete analysis of the nature and function of interest in every possible context. It seems that, in the context of industry, interest approximates 'a factor of the cost of production; in the context of consumption loans, interest approximates 'price or rent of borrowed money'; in the context of state bonds, interest approximates 'reward for deferring enjoyment of one's purchasing power; in the context of distress loans, interest approximates 'callous extortion or exploitation'. No single conception of the 'essence' of interest would thus suffice in all cases. Likewise, no ethical or economic appraisal of interest, in a blanket manner, would be valid. To arrive at a proper evaluation one must take into account the context and the exact function of interest in the type of situation under review. The concept of 'increment' which interest logically implies is, ethically, an indeterminate concept. We shall now briefly review some of the different conceptions of interest without attempting any reductive definition.

One conception of interest is that it is the price a borrower is required to pay

for satisfying a need he is unable to satisfy from out of his own available money. The excess payment he makes to the lender, over and above the principal amount, is the price of the borrowed money. Another conception is that the excess is the rent for the use of money belonging to the lender. Yet a third conception is that interest is the lender's claim to be compensated for depriving himself of the actual or possible enjoyment of his own wealth which he places at the borrower's disposal. In the context of trade and industry, interest is a relatively small fixed charge upon the theoretically larger profit of enterprise. It may be viewed as guaranteed unearned profit whose justification is that the supplier of capital (one of the necessary conditions of production) is entitled to a small but assured return, for lending capital to the producer who expects to get much larger returns through profits.

The other factors of production (apart from capital) are land, technical skill or know-how, management, labour, and last but not least, leadership and organizational capacity of the entrepreneur. Now each factor of production is severally and jointly essential for the success of the enterprise and thus deserves just consideration. However, entrepreneurial leadership and the supply of capital do occupy a unique position or status in the sense that they jointly create the 'productive space' for the inception and future growth of the enterprise. Without such space having been antecedently provided by the capitalist or the 'captain of industry', the social organism comprising management and labour, would not have come into being at all. It is, therefore, understandable that the founders and directors of the productive enterprise claim a higher status and a larger share in profits of the enterprise, while the management and labour receive fixed salaries for specified jobs. Between the capitalist and the industrialist, if the former supplies money capital, the latter supplies the 'ideational/volitional capital'--the creative idea, and organizational initiative. The two together create the base for the subsequent productive role of labour and management. Once the organism is born and the infant plant

becomes an adult organism, the role of the management and the workers also acquire a key role in raising the productivity and quality of the enterprise. But at the initial stages the capitalist and the entrepreneur do play the crucial role of conceiving and producing a new social organism as such.

If all the different factors of production could, possibly, be supplied by one super-human individual, he/she could rightly claim to appropriate the entire profit. This is not possible when large investments are made. The need for capital is fulfilled through various mechanisms or modalities: the accumulation of share capital, borrowing on interest (from an individual or a bank or the state or some corporation, or by entering into a partnership). Now is there, really, any conceptual/or ethical difference between the above modalities?

I think they are essentially the same. They are all characterized by a common feature—a claim for monetary return on the strength of some productive contribution towards turning a mere idea or project into a productive concern? And how can this claim be adjudged as morally repugnant in some cases but right in others? It is true that a sleeping partner in an Islamic partnership bears a risk, while the lender of money on interest gets a risk-free and safe return. But how does this economic difference amount to any inherent social injustice. It may be said that the concept of a fixed interest, whether the venture succeeds or fails, is morally evil. But (as stated above) the lender also needs a measure of protection.

In short, we can not hold that interest is immoral or inherently evil like we judge other wrong actions such as murder, rape, falsely incriminating an innocent person and the like. The abhorrence with which many Muslims look upon interest (which they judge as the root of social or economic ills) arises when they mix different types of financial operations or mechanisms with each other. They firstly confuse the modern idea and function of interest with ancient

usury. They also confuse developmental loans with distress loans, insurance with gambling, and risk-free low return schemes for investing one's surplus wealth or hard earned savings with inequitable perpetuation of unearned inherited wealth at the cost of the poor, and so on. In other words, committed Muslims owe it to themselves to overcome their confusions instead of passing a blanket judgment on the issues of interest and investment returns. There can be no doubt that interest in the modern sense is nothing but a thin slice carved out of much larger expected profits and its function is certainly not to exploit the poor but just to protect the legitimate interests of a large segment of society.

It is true that paying interest to the creditor adds up to the total cost of productions and thus certainly adds to the market price of goods and the rigors of the producer. But then it promotes a proper climate for industrial and commercial investments and promotes a ceaseless concern for reducing production costs in a highly competitive market economy. Both its advantages as well as disadvantages must be kept in mind in order to arrive at a balanced perspective.

Indeed, most economists are of the view that interest performs an irreplaceable socio-economic function and that all efforts to eliminate interest from society are futile. It is significant that socialist thinkers and reformers as Robert Owen (d.1858) of Britain, Rodbertus (d.1875) of Germany, had condemned interest and advocated its abolition. Marx and Lenin, however, did not hold interest to be the arch evil. Though the Soviet Union had excluded interest, as a cost factor, in the early period just after the Russian Revolution of 1917, their ideologues later on gave up this approach. Socialist planners rejected the Capitalist system of production, yet they included interest for computing the total cost of production and for fixing the consumer price.

In short, interest is an economic tool performing several functions only some of which could be taken up by the Islamic partnership model of profit and loss sharing. Social scientists, almost without exception have concluded after prolonged enquiry that there is no effective substitute for interest just as an overwhelming majority of social philosophers and enlightened statesmen affirm that despite the evils of democracy no better substitute is available to the human family.

### **Concluding Reflections:**

Islamic intellectuals and religious leaders must realize the plain truth that the economic directives of the Quran or the classical Islamic polity that gradually developed in early Islam will not suffice in modern times without developing the early economic models and modalities in the light of modern social sciences. The Quranic economic axioms are certainly valid, but they need to be developed in the light of 'economic. rationality'. Committed Muslims could, if they so wish, call the developed economic system Islamic or Quranic. Let me explain this crucial point.

The Quranic fixed coordinates of the economic system are only two: (a) the prohibition of usury and (b) the wealth tax (*zakaat*). Now all religions prohibit exploitative rates of usury but allow what should be called interest. However, Muslim jurists go by the literal meaning of words and totally disregard the fact that their significance or directive function may clearly change in changing times. They do not see the genuine distinction between the modern concept of 'interest' and the ancient or medieval notion of 'usury' and (innocently) assert that the Quranic term 'riba' covers both. The same remarks apply to '*zakaat*. In some form or other all religions ordain the rich and affluent among the faithful to care for and generously help the deprived and the weaker sections. The Quranic rate of 2.5% of the net surplus should not be deemed to be a rigid or

permanently fixed figure but only a minimum figure as a general guideline for Muslims. To my mind, following an 'open' approach to the Quranic economic axioms would converge with the theories and policies of the school of 'Welfare Economics'.

Islamic economists often criticize that western economists do not show any concern for values other than maximal growth of material wealth, while Islamic economics is focused on welfare and compassion for all. However, all contemporary social thought interprets the idea of 'economic rationality' as inclusive or fully integrated human welfare that includes material prosperity as an important dimension or ingredient of the human development index (HDI). Economists, in their capacity as pure social scientists, may well suggest models of rapid economic growth (in the restricted sense) without moral or humanitarian constraints or considerations. But it is obvious that they are not allowed to cross certain limits that are set by democratic consensus rather than by purely or exclusively economic considerations. Thus, the protagonists of welfare economics adopt the same basic approach as do Islamic economists.

The basic spiritual and moral values of all universal religions and also secular value systems are essentially similar even though they differ in their theological beliefs and social customs. Such differences, however, do not negate their basic agreements which suffice for peaceful coexistence and a sense of harmony. In fact whenever a genuine meeting of minds and hearts takes place between diverse groups, a process of mutual learning is set in motion. Does not this go to show the potential unity of basic values underlying the plural metaphysical beliefs, myths, symbols, rites and rituals of the human family?

The fact of the matter is that liberal humanists, Utopians scientific socialists and Gandhian reformers, no less than Islamic economists, stand for the same values in the long run (despite, obviously, differing on details and on the best means for reaching the values concerned). To suppose that the Marxists or the liberals are

oblivious to higher values and that creating material plenty is their only objective is to distort the true picture. Thinkers, reformers teachers, poets and artists of the human family as a whole, have the same dreams and aspirations. We register, even magnify, the lapses of others in their pursuit of power; we hardly notice our own lapses. In the final analysis, therefore, the fault lies in the human clay rather than exclusively in any particular system. And, while we can modify or even replace systems, we cannot alter the human clay, much as we may educate or 'condition' it. Wisdom lies in continually improving the system in the light of actual experience rather than .of priori formulae (religious or secular) and striving to purify the clay without expecting miracles of success and without losing the heart to march along, despite falls and failures, on the endless road to Utopia.<sup>5</sup>

The contemporary movement of Islamic Resurgence aims to overcome the inertia and stagnation of the Islamic world for the past several centuries. This is very welcome, indeed. However, the worldview of their leaders and ideologues suffers from a grave limitation. They have failed to realise the nature and the impact of the scientific revolution of the 18<sup>th</sup> century upon the religious sensibility of the modern age. In other words, they continue to believe in the medieval view that all religions, particularly, Islam is a total code of life applicable to every aspect of human life. This basic approach, inevitably, leads to a rejection of spiritual pluralism and reinforces sectarian communitarianism in some form or other. The earlier 'Islamic liberalism' of the late 19<sup>th</sup> century, led by Sir Syed of Aligarh, Abduh of Egypt, Iqbal and Azad and their associates, on the other hand, stood for a spiritualized humanism and a secular approach to politics. Their vision of Islam affirmed that the essential concern of religion is with the transcendental or spiritual dimension of human life, not with political, economic, cultural and administrative concerns. They were quite clear that the essential function of religion in an ever changing human situation was inspirational rather than legalistic. The contemporary resurgence movement, on

the other hand, for various political reasons, has back-tracked on the earlier liberal humanist approach to Islam and regressed to the medieval view that religion should provide a total code or blue-print of the 'good life' for the true follower. The contemporary champions of Islamic resurgence, for example, the Jamaate Islami, merely seek to 'adjust' the 'shariah' for meeting contemporary needs, without realizing that there is any need for a deeper questioning of the medieval view of the function and proper jurisdiction of religion in human society and state. In other words, the contemporary movement accepts the medieval theory of religion as a complete and 'totalist' map or code of conduct in every walk of life. This is the essence of what has come to be known as 'religious fundamentalism' or the 'fundamentalist approach to religion', no matter what its creedal content or name. In this sense there is not only 'Islamic' fundamentalism, but 'Hindu' fundamentalism, 'Christian' fundamentalism, 'Sikh' fundamentalism and so on. The implications of this approach are far reaching, indeed, since this approach implies the definitive rejection of the generic liberal approach in the case of all religions as such, rather than merely of liberalism in the house of Islam. This is why the opponents of liberal Islam also oppose liberal Christianity, liberal Judaism, liberal Hinduism or Buddhism and so on. They (perhaps unconsciously) denigrate the 'liberal attitude' or mind-set as such in the case of all historical religions and judge their emerging liberal versions in the course of history as unwanted aberrations or deviations from their true original. It is common to hear them say that the liberal reformed Protestant Christianity that emerged in the West under the impact of modern science and the industrial revolution is a toothless degenerate version of Church Christianity. Likewise, the liberal Islam of Muslim reformers or statesmen of the 19<sup>th</sup>, century in Egypt, India, Indonesia etc is only an apology for rather than true Islam as such. In short, the ideologues of the contemporary form of Islamic resurgence devalue the contribution of the Islamic liberals of the last two centuries. Rather than take up the torch the liberals had lighted and going forward to complete the unfinished agenda of such noble and enlightened Islamic liberals as Muhammad

Abdullah of Egypt, Sir Syed, Iqbal and Abul Kalam Azad of the Indian sub-continent, the champions of theocracy and Islamization limit their task to the 'adjustment' of the 'shariah' (as a total code of conduct) to modern times. They have no inkling of the deeper issue of redefining the proper function and jurisdiction of all religions (including Islam) in the age of modern science and technology and a global society. What is really needed is that the Muslim mind liberates itself from several unquestioned assumptions that are not integral to the essence of the Islamic faith, though they have entered into mainstream Islam due to various factors.

### **Notes and References to Economics System:**

1. Though the Quranic command to cut off the hands of the thief is categorical, the shariah admits of several exceptions, namely, when the thief and the victim are close blood relations, or when the stolen amount is below a prescribed minimum. It is also waived in the case of eatables, musical instruments and some other articles.

2. Usury on distress loans has been universally disapproved and morally condemned because it implies turning the suffering of a fellow human into an opportunity for material profit. In ancient Babylonia Hammurabi (app.2000 B.C) sought to regulate the rate of usury. A new king often declared the cancellation of all debts at the time of his coronation. Judaism prohibited usury in the strongest possible terms making no distinction between distress loans and loans for any other purpose, but permitted Jews to charge usury from Non-Jews. The Christian canon law made the prohibition universal. In the middle ages Thomas Aquinas (d.1274), the greatest medieval Christian theologian, made a distinction between distress and commercial loans, but the canon law was not altered. In practice, however, the prohibition was conspicuous by its violation due to economic compulsions.

The religious leaders of the mercantile Italian city-states of the early modern era, Florence, Venice and others ( which were the pioneers of modern international commerce and banking) were the first to question the ethical and religious validity of the absolute Christian prohibition of interest without distinguishing it from usury when commercial practice had already sharply deviated from canon law. It was, however, John Calvin (d.1564), the great Swiss Protestant reformer, no less influential than his more internationally famous German contemporary, Martin Luther, (d.1546) who forcefully pleaded that while usury was morally repugnant, interest on commercial and development loans served social needs. The above approach found ready acceptance in Britain – the first industrialized country in the modern sense and also the country where the seminal work, *The Wealth of Nations*, published in 1776, by the philosopher, Adam Smith (d.1790) gave birth to Economics as a social science. Significant contributions by Jeremy Bentham (d.1832), J.S Mill (d.1873), Ricardo (d.1832), Malthus (d.1834) and others followed to enrich Economics as a pure social science.

The growth of theoretical Economics and the practical constraints of rapid industrialization fostered a new outlook on social and religious problems. The legal prohibition against usury was repealed. Soon afterwards, the statutory ceiling on the rate of interest, and the legal penalty for violating the maximum limit, was removed in the early 19<sup>th</sup> century in Britain and elsewhere under the influence of the philosophy of *laissez faire* liberalism, that is, uncontrolled reign of the market price. .

The middle of the 19<sup>th</sup> century, however, saw a reaction against the doctrine of absolutely free and uncontrolled market economy. Several sensitive minds began to think that the much-lauded free market economy had bred numerous social and economic evils-uncontrolled urbanization, poor-house poverty, crime, social uprooting, anonymity, alienation, dehumanization of labour, unemployment, all flourishing in the midst of and despite mass production and

affluence. The ideas of cooperative production, state regulation, and finally, of socialism came to the fore in order to remove the grave imbalances created by the free interplay of market forces. There was a spate of social welfare legislation and economic regulations in western countries to protect the weaker sections. Institutional arrangements were made for the supply of cheap credit to the needy and for protecting insolvents. Thus, while the religious prohibition against usury was done away with, its basic objectives- the protection of the interests of the weak was sought to be promoted by means of democratic and socialist ideals. Liberal Christian thought contributed to this development but conservative, rather static, quarters within the Church were reduced to the position of perplexed and helpless spectators of the new emerging values.

To complete the picture, a few remarks may be made concerning the ancient Indian approach to usury. The *Dharmashastras* also strongly disapprove of usury on distress loans. Indeed, one *Dharmashastra* declares that usury (*kuseed*) in the case of a distress loan is a greater evil than even the murder of a Brahman (*Brahmhatya*). However, commercial interest is permitted. Different law-givers prescribe different rates of interest bearing in mind different relevant factors and also safeguarding the legitimate interests of the creditor and the debtor and also of the society in general. However, it must be pointed out that there was caste discrimination while fixing the varying rates of interest (the rate being lowest for the Brahman borrower, approx.15% per annum). Moreover, the general rate of interest was much higher than is the case in modern times. Buddhism followed the Hindu practice but without any caste bias.

3. Ghulam Ahmad Parvez and some others are inclined to Socialist ideas, Mawdudi, Baqir Al-Sadra and others to free enterprise. See Nijatullah Siddiqi: Survey of Islamic Economic Thinking, Leicester, UK ,1980, pp.46-53

4. Edmund Husserl (d.1938) first elaborated the concept of 'epoche'. This means complete suspension of all previous judgments and adopting the posture of 'epistemic openness' without any evasion or unconscious slant and the maximum possible effort to mentally grasp the structure and inter-relations of a specific concept or belief.

5. The prohibition of interest, the institution of zakaat, the implementation of the Islamic law of inheritance, severally or jointly, would not suffice to solve our complex problems. When there is urgent need of capital for macro development national defence, acute distress or natural calamity etc borrowing on interest becomes unavoidable. Zakat will not do when savings are almost zero. Islamic inheritance will not do when all there is to inherit is poverty and disease.

Moral exhortations will not do when the facts of life have been ignored. The nationalization of means of production will not do when productivity remains low. No economic system will work if we do not give up romantic illusions concerning human nature.

