

# [Islamic economic system](https://assignbuster.com/islamic-economic-system/)

[](https://assignbuster.com/)[Economics](https://assignbuster.com/essay-subjects/economics/)

INTRODUCTION Islam is a complete code of life which offers its own social, political and economic systems to guide human behavior in all spheres of life. History has recorded that the economic system of Islam, for the first time in the world had established social and economic justice during the period of al-Khilafah al-Rashidah. In any ideal Muslim society, socio-economic justice is considered as one of the most significant characteristics for the social, political, and economic as well as all realms of human interaction.

Exploitation and any source of unjustified enrichment in Islam are prohibited. The Holy Qur’an has emphatically instructed Muslims not to acquire each other’s property wrongfully. Islam is not an ascetic religion. It takes a positive view of life as the natural outcome of the belief that human beings are the vicegerents of Allah (Swt). The conditions for interest/riba has been laid down as increase in principal amount and increase withrespectto payment period, the more period causes more increase. Interest/riba has been categorized into two types.

After describing interest/riba and its types, reasons have been sought for prohibition of interest/riba from Quran referring to Surah Al-Rum-39, Surah Al-Nisa-161, Surah Al-Imran 130-2 and Surah Al-Baqrah 275-281. Help from Hadith (Muslim, Ahmed, Tirmidhi and Ibn-e-Majah) has also been sought. Interest/riba generates various evils like moral evils, social evils and economic evils. Thegoalsof socio-economic justice and equitable distribution of income and wealth are integral parts of the moralphilosophyof Islam.

However, one of the socio-economic reforms made by Islam was the prohibition of riba (interest). About the efficacy and usefulness of the prohibition of interest in Islam, Muslim economists have tried to provide the juridical clarity and support based on reason, as opposed to mere belief. The purpose of this paper is to spell out the meaning of riba or interest, its different kinds, and the social, moral, as well as economic rationale of its prohibition.

The central feature of an Islamic financial system is the absolute prohibition of the payment and receipt of interest. Thus, countries that have chosen to bring their economic systems into closer accordance with the rules prescribed by Islamic law have had to restructure their banking Systems to conform to the restriction on interest based financial transactions. One of the main subjects in Islamic economy is study on ration of usury to currency devaluation compensation.

In Iran which average inflation rate has been 20% during the last 30 years (that is prices have been averagely multiplied by 240 in the last 30 years) on the one hand and currency devaluation compensation is regarded usury on the basis of traditional definition of usury on the other hand, the fact that devaluation compensation is considered as usury causes the holders of interest free deposit to face continual and evident devaluation and then cause the holders of fixed salary and cash asset to have zero purchasing power over time and some will benefit (including government and then owners of estates) and some will lose.

The incurred loss will be the same as the benefit of some beneficiaries leading topovertyof the poor and wealth of the rich and violation of rule of dominance in private ownership. On the basis of traditional jurisprudence, compensation for currency devaluation is regarded the same as inflation rate and non compensation will lead to undesirable consequences.

In this article, this traditional attitude has been challenged and we can say that compensation for decrease of purchasing power which is the same as inflation rate is not only usury but also necessary with regard to economic changes in the current era and this is closer to justice recommended in religious law. With regard to the mentioned material, importance of currency devaluation compensation is made evident.

In fact, this article seeks to answer this question whether currency devaluation compensation is one of the usury evidences or not and if it is necessary to compensate it in transaction (especially in term transaction)?. Substantive hypothesis of this research is that compensation for purchasing power decrease in transaction (especially in loan) is necessary. Much has been written on the interpretation of the term “ interest/riba”, Interest on the wisdom underlying its prohibition, on its economic and social implications and on the practical aspects of the Islamic economy which is supposed to work without interest.

It is explained that the people not conversant with principles of Islam and economic philosophy of Islam believe that elimination of interest/riba from banks and financial institutions makes them charitable, rather than commercial concerns which offer financial services without a return. This is their wrong assumption that interest free loan is meant for cooperative and charitable activities and not normally for commercial transactions. It is clear that elimination of interest from financial activities does not mean that lender cannot earn profit.

If financing is made for commercial purpose, it can be based on the concept of Musharakah and Mudarabah. Islam animated novel systems which were beyond the reach and perception of human beings to think and develop. LITERATURE REVIEW Much has been written on Interest and its evils. Prohibition of interest in Islam is basically is an effort to prevent the society from the evils of interest. Interest free economy is an ideal economic system, model of which is presented by Islam through Qur’an and Hadith.

Prophet Muhammad (S. A. W) laid down the basis of interest free economic system 1400 years ago and Khulfa-e-Rashidain carry that work and establish an economic model that is role model for today’s economists and for those who are contributing their efforts for establishing an Interest free economic system. Regarding subject matter in the present article which studies relationship between them, the related literature (except Qur’an & Hadith) relates to the recent 30 years.

Islamic prohibited Interest as Qur’an Said: “ Allah deprives riba of all blessing and develops charity” (Al-Baqara-276) “ The interest that you give in order to increase the wealth of the people, does not increase in the sight of Allah” (Al-Rum-39) Basic concept of Interest/riba is explained by Qur’an, Hadith, Islamic and other scholars in an easy way. Fourth Revelation (Surah Al-Baqarah, verses 275-281) “ Those who devour riba will not stand except as stands one whom the evil one by his touch hath driven to madness. That is because they say: “ Trade is like riba”.

But Allah hath permitted trade and forbidden riba. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge). But those who repeat (the offence) are companions of the fire; they will abide therein (forever). ”(275) Allah further said: " O you who believe, observe your duty to Allah and give up what remains (due) from interest, if you are believers. But if you do not do it, then be warned of war from Allah and His messenger; and if you repent, then you shall have your capital.

Do not exploit and be not exploited. " (2: 278-279). The Holy Prophet (S. A. W) has advised Muslims to avoid seven harmful things and the third among these is interest, He stated,' although interest brings increase, yet its end tends to scarcity’. From Jabir (RAA) The Prophet, (PBUH) may curse the receiver and the payer of interest, the one who records it and the two witnesses to the transaction and said: “ They are all alike [in guilt]” (Muslim, Tirmidhi and Musnad Ahmad).

From Abdullah Ibn Hanzalah (RAA) the Prophet (PBUH), said: “ A dirham of riba which a man receives knowingly is worse than committing adultery thirty six times” (Mishkat al-Masabih, Kitab al Buyu, Bab al riba, on the authority of Ahmad and Daraqutni). Bayhaqi has also reported the above Hadith in Shu’ab al-imam with addition that “ Hell befits him whose flesh has been nourished by the unlawful. ” From Abu Hurayrah (RAA): The prophet, (PBUH), said: “ There will certainly come a time for mankind when everyone will take riba and if he does not do so, its dust will reach him. Abu Dawud, Kitab al Buyu”, Bab fi ijtinabi al-shubuhat; also in Ibn Majah) From Abu Hurayrah (RAA): The Prophet, (PBUH), said: “ God would be justified in not allowing four persons to enter paradise or to taste its blessings: he who drinks habitually, he who takes riba, he who usurps an orphan’s property without right, and he who is undutiful to his parents” (Mustadrak al-Hakim, Kitab al-Buyu) Above illustrated Verses from Holy Qur’an and Hadith explain the meanings and its status in Islam.

Prohibition of Riba Act 1997 states that riba is an stipulated payment over and above the principal amount lent in consideration of the time given for repayment, either on simple or compound basis or any discount given on assignment of debt or any financial paper representingmoney. Chapra (1985) explains that “ Riba literally means increase, addition, expansion or growth”. Even among secular literature, one finds criticism on interest. Aristotle (384-322 BC) in his book “ Politics” criticized interest in following words “ Of all modes of getting wealth, this is the most unnatural".

In value neutral economics too, we find criticism on interest. Keynes (1936, p. 377) in his monumental work “ General Theory of Income, Employment, Interest and Money” reasoned in following words: “ Interest to-day rewards no genuine sacrifice, any more than does the rent of land. The owner of capital can obtain interest because capital is scarce, just as the owner of land can obtain rent because land is scarce. But whilst there may be intrinsic reasons for the scarcity of land, there are no intrinsic reasons for the scarcity of capital.

An intrinsic reason for such scarcity, in the sense of a genuine sacrifice which could only be called forth by the offer of a reward in the shape of interest, would not exist, in the long run, except in the event of the individual propensity to consume proving to be of such a character that net saving in conditions of full employment comes to an end before capital has become sufficiently abundant. But even so, it will still be possible for communal saving through the agency of the State to be maintained at a level which will allow the growth of capital up to the point where it ceases to be scarce”.

Tahir (1999) describes that riba is a discrepancy which results from the contractual obligations of a party in the context of a direct exchange of items of the same general kind (such as loan transaction) between two parties. Encyclopedia American International Edition (1970) expresses the meaning of interest that it is a charge for the use of money. Interest has not always been considered legitimate or even moral payment. Until the end of middle ages, any charge for a loan was general considered to be usury.

Teachings of Christian, Judaic and Islamic religion, all condemned in varying degrees, the taking of interest, in more recent times, however, usury has come to be regarded as only the charging of illegal rates of interest. “ The interest that you give in order to increase the wealth of the people, does not increase in the sight of Allah; and the Zakat that you pay in order to win Allah’s approval, its payers do indeed increase their wealth” (Surah Al-Rome no. 39)(Shafi and Usmani, 1997, p. 67).

It is beautiful and powerful statement from Quran which shows that interest is prohibited by God because it can only increase the wealth of individual not the society. “ Exclusion of interest from financial activities does not necessarily mean that the financier cannot earn a profit. If financing is meant for a commercial purpose, it can be based on concept of profit and loss sharing, for which Musharakah and Mudarabah have been designed since the very inception of Islamic commercial law” (Usmani, 2005, p. 10).

It is wrong and confused concept in the society about the operation of the Islamic banking system but Islam provides an alternative system where everyone contributes their share of investment and earns profit. In case of losses all the parties of contract suffer according to their agreed terms and conditions. Islamic financial system is being only successful if all the financial activity will be performed according to Islamic financial law Islamic banking is a very strong sector of interest free economy; Islamic anking can be a true alternative of conventional banking. The Organization of Islamic Conference (OIC) defined an Islamic banking as “ a financial institution whose statutes, rules and procedures expressly state its commitment to the Principles of Islamic Shariah and to the banning of the receipt and payment of interest on any of its operations” (Hassan, 1999, p. 60). According to this statement it is clear that interest is fully prohibited in Islamic law due to its bad effects onhuman beingand more badly effects on overall society and economy.

In an interest based economy a trend arises that rich people create the methods to increase their wealth through effecting the middle and lower classes. In interest based economy the middle class cannot contribute positively in economic system then gradually the economy travel toward financial crises such as credit crunch. An Islamic bank is an intermediary and trustee of other people’s money with the difference that it shares profit and loss with its depositors.

In practice the most Islamic banks have an organizational set-up very matched and similar to their conventional counterpart banks (Dar and Presley, 2000). “ Islamic banking is phenomenally profitable because, although its underlying funding mechanism is the same as conventional banking, its default experience is better, and its charges higher and less transparent” (Cook, 2006, p. 16). It is resulted from above statements that Islamic banking is not totally different from conventional banking.

They are doing same practice such as saving deposits and consumer finances but there are some fundamental differences of its practice and objectives. Islamic banking is interest free and its main objectives are the equal distribution of wealth, decreasing the poverty and increasing the investment opportunities. It is very beneficiary for Muslim population who want to solve all their financial matter according to their religion. Because a number of Islamic and some high street commercial banks from all over the world offer products and services that are according to Shariah compliant (www. tandardchartered. com). Islamic and traditional banking actually are not different. The both banking system has same objectives and practice the only difference of implementation of interest because interest is totally prohibited in Islam. Islamic banking falls into the realms of conventional banking; Islamic banking try to ensure that all their financial matters according to Islamic financial law as well as the rules and regulations of a articular state like the Financial Services Authority (FSA) in the United Kingdom (Shanmugam, Perumal and Ridzwa, 2004). Islamic banking almost provides same services as conventional banking such as current accounts, saving accounts, insurances, mortgages and investment opportunities in the society. Regarding usury or currency devaluation and its related issues, there are abundant economic literatures. Its reason is that this subject has not been raised as main and serious subject in the past.

In Sunnite world, the above issue has not been seriously raised. Perhaps, the main reason is that this issue becomes important in the country like Iran which usury free banking has been executed completely due to close relationship between currency devaluation compensation and usury free banking. In fact, by study on history of Islamic banking in world of Islam especially in literature of Sunnites, we notice that history of Islamic banking is divided into two periods: firstly, when it has been raised as an ideal form and secondly, when it has been realized.

Principle of attention to usury free banking idea is found in book Anvar Eghbal Goreishi (1946) (Naem Sadighi 1948) and Mohammad Ahmad (1952) and consequently, professional elaboration of Mododi in 1950(1961) and writings of Mohammad Hamidollah in 1944, 1955, 1957 and 1967 are included in this group. In all of these works, bailment means participation on the basis of profit and loss was suggested as main mechanism for usury free banking idea (Abdul Ghafoor, 1955). In the next two decades, usury free banking attracted many attentions; efforts of researchers about this subject started in this period.

The first works related to Mohammad Azir (1955) and afterward, Abdullah Arabi (1967), Nejatollah Sadighi (1961, 1969) and Alnajar (1971) and Sadr (1961, 1974) published works in this field in late 1960s and early 1970s (Sadighi 1997, P222). These governmental efforts and assistances led to application of theory in reality and the first usury free bank i. e. Islamic Development Bank was born out of this process in 1975. Afterward, different researches were published in the field of usury free banking.

Works done by Mir Akhor (1989), Farokh Omar(1985), Khan (1986), Asif Ahmad (1997), Motahari(1403 AH), Mosaei(1998, 1999, 2001, 2003, 2004), Adib Soltani (1996, Bakhtiari (1996), Beheshti (1989), Taskhiri (1996), Tootonchian(2000) , Davoodi (1995), Marzban(1977), Mesbahi (1997), Hedayati (1996), Yousefi (1998), Arif Mohammad (1988) and Musai (1997, 2001) belong to this category. The first private usury free bank was Dubai Islamic bank which was established in 1975 by a group of Muslim merchants from many countries. Afterward, two other private banks called Feisal Islamic Bank was established in Egypt and Sudan.

In the same year, Kuwait government established KuwaitFinanceHouse. But before this date, usury free banking has been available in small and limit scale such as banking in Malaysia in the middle 1940s and another one in Pakistan in the late 1950s. With regard to these experiences, Naser Social Bank was established in 1972 which is available now and its goals are social rather than commercial. During the next 10 years, more than 50 usury free banks were formed out of establishment of the first private commercial bank in Dubai. Most of these banks are in Muslim countries.

But many are available in West Europe in Denmark, Luxemburg, Switzerland and England. In 1983 and1984, many banks were established but afterward, the number of these banks has decreased. METHODOLOGY Since this study was secondary data based, no primary data collection methods were followed. Data was collected from various scholarly articles related to studies. Books on Islamic economics were also consulted and considered for data collection. Data related to Zakat, usher, fidia, jizia and charity was collected from Qur’an and Hadith. And authenticity of data was confirmed by Ulma so that any misconception could be prevented.

Scholarly articles and related studies were carefully studied and most related data was taken for report. After rigorous study of literature available, a comparative analysis of various sectors of economy was performed. Comparison of Zakat and tax, conventional and Islamic banking, monetary and fiscal policy and also a brief discussion of inflation is included. After comparative analysis and deep discussion of data collected an effort is made to develop an interest free economy model in Pakistan. COMPARATIVE ANALYSIS Much has been written on the interpretation of the term “ interest/riba.

We have expand our discussion more and try to explain the meanings of interest, its implications in different sector of economy and also try to produce free model of economy, sector wise. INTEREST Interest is the money paid for the use of money lent, or for delaying the repayment of a debt. The economy today is based on the system of interest. It has its merits and demerits, but if we analyze it in accordance with the Islamic injunctions and teachings, then we come to realize that this system of interest is not viable for the Muslims, and it undermines the human and cultural values.

Interest is the basis of modern capitalism. It is completely opposite to Zakat. Zakat channels wealth from the rich to the poor while interest takes away wealth from the poor and hands it over to the rich. Modern economics are so inter-linked with interest that people may think it is impossible to go without it. The situation is really very complex. But, we must aim at getting rid of interest. Unless people fight against the tyrant rulers and establish an Islamic state -the problems will still be there. Further, until Islamic state established, it will make us feel impossible to solve this riba (interest) problem.

Allah SWT has not imposed on us something impossible. An interest-free economy will be a boon for all peoples of the world. INTEREST and ISLAM Interest (riba) has been vehemently disapproved in Islam. Islam prohibits all transactions involving interest. This prohibition is for all interest-based transactions, whether giving or receiving, whether dealing with Muslims or non-Muslims. It is reported that the Prophet Muhammad (peace be upon him) cursed those who pay interest, those who receive it, those who write a contract based on it, and those who witness such a contract. Interest is neither a trade nor a profit.

It is a means of exploitation and concentration of wealth. PROHIBITION OF INTEREST IN QURAN AND SUNNA’H " They say, trade is like interest and Allah has allowed trade and prohibited interest. " (2: 275). " Whatever you pay as interest, so that it may increase in the property of (other) men, it does not increase with Allah. "(30: 39). " O you, who believe, do not take interest, doubling and quadrupling, and keep your duty to Allah, so that you may prosper. " (3: 130). " O you, who believe, observe your duty to Allah and give up what remains (due) from interest, if you are believers.

But if you do not do it, then be warned of war from Allah and His messenger; and if you repent, then you shall have your capital. Do not exploit and be not exploited. " (2: 278-279). " Those who devour usury will not stand.... Allah has permitted trade and forbidden usury.... Allah will deprive usury of all blessing, but will give increase for deeds of charity.... " (Qur'an 2: 275-6) The Holy Prophet of Islam has advised Muslims to avoid seven harmful things and the third among these is interest, He stated,' although interest brings increase, yet its end tends to scarcity’.

In several verses of the Holy Qur’an, Allah (Swt) has mentioned the consequences of riba. The Qur’an did not declare the prohibition of riba in the early stage of revelation; rather we find that the complete prohibition of interest came sequentially. In the Qur’an Allah (Swt) says: “ That which ye lay out for increase through the property of (other) people, will have no increase with Allah: But that which ye lay out for charity, seeking the countenance of Allah (will increase): it is these who will get a recompense multiplied”. 30: 39) “ That they took riba (usury), through they were forbidden and that they devoured men’s substance wrongfully – We have prepared for those among men who reject faith a grievous punishment. ” (4: 161) “ O ye who believe! Devour not usury doubled and multiplied; but fear Allah, that ye may (really) prosper. ” (3: 140) “ Those who devour usury will not stand except as stands one whom the evil one by his touch hath driven to madness. That is because they say: ‘ Trade is like usury. ’ But Allah hath permitted trade and forbidden usury.

Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge). But those who repeat (the offence) are companions of the fire, they will abide therein (forever)” (2: 275) “ O you who have attained faith! Remain conscious of God, and give up all outstanding gains from Usury, if you are (truly) believers”. (2: 278) TYPES OF RIBA Although the Qur’an did not specify any particular kind of riba, it is generally held that the word al-riba in the Qur’an is that kind of dealing which had been in vogue during the pre-Islamic days.

Muslim jurists have classified riba in two types: 1. riba al-nasi’ah, and 2. riba al-fadal. Riba al- Nasi’ah The term nasi’ah means to postpone or to wait and it refers to the time period that is allowed for the borrower to repay the loan in return for the addition of the premium. Hence it refers to the interest on loans. The prohibition of riba al nasi’ah essentially implies that the fixing in advance of a positive return on a loan as a reward for waiting is not permitted by the Shari’ah. Hadith on Riba Al-Nasi’ah 1) From Usamah Ibn Zayd (RAA): The Prophet, (PBUH), said: “ There is no riba except in Nasi’ah [waiting]. (Bukhari, Muslim and Musnad Ahmad) “ There is no riba in hand to hand (spot) transactions: (Muslim, and Nasa’i). 2) From Ibn Masud (RAA): The Prophet, (PBUH), said: “ Even when interest is much, it is bound to end up into paltriness. ” (Ibn Majah and Musnad Ahmad) 3) From Anas Ibn Malik (RAA): The Prophet, (PBUH), said: “ when one of you grants a loan and the borrower offers him a dish, he should not accept it; and if the borrower offers a ride on an animal, he should not ride, unless the two of them have been previously accustomed to exchanging such favors mutually. (Sunan al-Bayhaqi) 4) From Anas Ibn Malik (RAA): The Prophet, (PBUH), said: “ if a man extends a loan to someone he should not accept a gift. ” (Mishkat, on the authority of Bukhara’s Tarikh and Ibn Taymiyyah’s al Muntaqa) Riba al-Fadal Islam, however, wishes to eliminate not merely the exploitation that is intrinsic in the institution of interest, but also that which is inherent in all forms of unjust exchange in business transactions. Riba al-fadal is the excess over and above the loan paid in kind.

It lies in the payment of an addition by the debtor to the creditor in exchange of commodities of the same kind. The following tradition of the Prophet Muhammad (saw) is cited as evidence. It is related that Abu Said al-Khurdi said: “ the Prophet Muhammad (saw) has said that gold in return for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, can be traded if and only if they are in the same quantity and that is should be hand to hand. If someone gives more or takes, then he is engaged in riba and accordingly has committed a sin. Islam is a complete code of life which offers its own social, political and economic systems to guide human behavior in all spheres of life. History has recorded that the economic system of Islam, for the first time in the world had established social and economic justice during the period of al-Khilafah al-Rashidah. In any ideal Muslim society, socio-economic justice is considered as one of the most significant characteristics for the social, political, and economic as well as all realms of human interaction. Exploitation and any source of unjustified enrichment in Islam are prohibited.

The Holy Qur’an has emphatically instructed Muslims not to acquire each other’s property wrongfully. Islam is not an ascetic religion. It takes a positive view of life as the natural outcome of the belief that human beings are the vicegerents of Allah (SWT). Hadith on Riba Al-Fadal 1) From Umar Ibn al-Khattab (RAA). The last verse to be revealed was on riba and the Prophet, (PBUH), was taken without explaining it to us; so give up not only riba but also raibah [whatever raises doubts in the mind about its rightfulness]. (Ibn Majah,) International Journal of Humanities and SocialScienceVol. No. 6 [Special Issue – March 2012] 149 2) The Prophet, (PBUH) said, “ Sell gold in exchange of equivalent gold, sell silver in exchange of equivalent silver, sell dates in exchange of equivalent dates, sell wheat in exchange of equivalent wheat, sell salt in exchange of equivalent salt, sell barely in exchange of equivalent barley, but if a person transacts in excess, it will be usury (riba). However, sell gold for silver anyway you please on the condition it is hand to hand (spot) and sell barley for date anyway you please on the condition it is hand to hand (spot)”. ) From Abu Sa’id al-Khudri (RAA): The Prophet, (PBUH) said, “ Do not sell gold for gold except when it is like for like, and do not increase one over the other; do not sell silver for silver except when it is like for like, and do no increase one over the other; and do not sell what is away (from among these) for what is ready. ” (Bukhari, Muslim, Tirmidhi, Nasa’i and Musnad Ahmad) 4) From „ Ubada Ibn al-Samit (RAA): The Prophet, (PBUH), said: “ Gold for gold, silver for silver, wheat for wheat, barely for barely, ates for dates, and salt for salt-like for like, equal for equal, and hand to hand; if the commodities differ, then you may sell as you wish, provided that the exchange is hand to hand. “(Muslim and Tirmidhi) Impacts of Interest on Economic System The present money system, based on the payment of interest, is unsustainable. Compound interest leads to exponential growth, which can be seen as a cancer on our social and economic system, a pathological growth pattern leading towards either economic or ecological collapse of unprecedented proportions.

Inflation is generally seen as a given and interest as a natural antidote to counteract it, while in fact interest is the major cause of inflation. Economic growth is needed at any cost, by continually increasing public and private debts. The interest system leads to an uneven growth of different sectors of the economy, indicating a severe sickness in the economic system. While the Net Income in Wages and Salaries rose 18 times between 1950 and 1995 in Germany, for instance, the Monetary Assets increased 461 times and the Gross National Product 141 times.

The global volume of speculative monetary transactions, arbitrating on the variability of currency values, amounts 97 % of all transactions, with a mere 3 % being in real goods and services. The daily volume of trading exceeds $ 2, 000 billion; all the currency and gold reserves in the world would only amount to the volume of seven to eight hours of trading! The interest system has devastating effects on theculture, ecology and society. It sucks up resources from regions with lower returns and redistributes them to the regions with high returns. EVILS OF INTEREST (RIBA)

The following evils are explained below which are happened due to interest in the economy. Moral Evils Interest generates such vices as miserliness, selfishness and petty-mindedness. Charity on the other hand develops such virtues as self-sacrifice, sympathy and magnanimity. The former are certainly a form of regression and the latter are signs of progress. Social Evils A society in which selfishness and self-interest are the prime values and people instead of dealing with one another on the basis of consideration are bent upon taking advantage of the pressing needs of each other will always remain victim of chaos and disunity.

In contrast, if members of a society are considerate and wish each other well, the society will make rapid progress. Economic Evils From an economic point of view interest results in even more serious losses. Following are some of the highlighted areas: I) Interest and Investment According to Lord Keynes capital investment depends on the one hand on the rate of interest and on the other on MEC (Marginal Efficiency of Capital). The process of investment in a country will continue as long as MEC is higher than the interest rate or at least at par with it.

As soon as MEC falls below the interest rate, the process of investment will come to a halt. This phenomenon may be illustrated by the following table: Investment| MEC| Interest Rate| 10 Million| 24%| 18%| 20 Million| 22%| 18%| 30 Million| 20%| 18%| 40 Million| 18%| 18%| Suppose the interest rate is 18% and an investment of Rs. 10 million is made on which the MEC is 24%. Since MEC is higher than the interest rate, investment is profitable. So the process of investment will continue. Now an additional investment of Rs. 10. 00 million is made on which the MEC declines from 24% to 22%. Investment is still profitable.

So the process of investment will continue until MEC is equal to interest rate. As the above table shows at an investment of Rs. 40 million the MEC is at par with the 18% interest rate. After that the process of investment will stop because MEC will fall below the 18% rate of interest. The investment will then be non profitable. At this point the only hurdle in the way of investment is the interest rate. Further investment will continue only if the interest rate is reduced. If the interest rate is decreased to zero, the process of investment will continue till the level of full employment is achieved.

II) Interest and Price When interest (as compensation for capital) is used as a factor of production it becomes part of the cost of production. Its burden is consequently shifted to the consumer. Moreover, interest is not added to the price once only, but it continues to be added to the price at several stages. Take the case of manufacturing of cloth. In the first place, the farmer will add interest to the price of cotton. Interest will again be added to the cost of production of yarn. It will be added to the cost of weaving, then to the cost of dyeing and finally to the price of finished cloth.

Thus at every stage of production, interest enhances the price of goods which is totally unjustified. Interest by increasing the real price manifold causes inflation. III) Interest and Distribution of Wealth The distribution of wealth in a society becomes inequitable due to interest. Interest is an overhead charge which does not form part of any factor of production. Interest is received by the capitalist who continues the use his wealth to earn more wealth. Hence instead of circulating in the society, wealth is concentrated in the hand of the capitalist class.

This causes an unjust distribution of wealth in the society. In this way due mainly to interest the rich in the society get richer and the poor, poorer. In regard to the distribution of Wealth, Abdul Qadir Salim writes in the October 1997 issue of the Tarjuman-ul-Quran: “ Now when there is no significant rival to the capitalist system, what is the situation in the world? In this age of free economy and privatization twenty per cent of total world population is still living below the poverty line and its share in the gross wealth of the world is only 1. 5%. The poor are getting poorer.

Growing poverty is not the problem of the third world alone. The advanced countries face this problem too. Sixty per cent of world’s resources are controlled and consumed by the twenty per cent rich. The prestigious journal “ The Economist dated 5th Nov. 1996” complains: Never during the last fifty years has there been such as large gap in incomes in Britain as there is today. In other industrialized countries also the gulf between the rich and poor has widened. International Journal of Humanities and Social Science Vol. 2 No. 6 [Special Issue – March 2012] 151 IV) Trade Cycle and Interest

Interest creates trade cycles also. It plays a special role in bringing about a slump in the market. According to Hawtray’s Monetary Theory, the Banks issue loans with a free hand when the trade is brisk but as soon as signs of a slump appear they start of trade cycles recovery of the loans. In this way capital shrinks and the slump starts declining to its lowest level. V) Interest and Allocation of Resources Chapra (2000) expresses in Tarjuman-ul-Quran: Financial institutions operating on the basis of interest evaluate the resources of the applicants for a loan.

They demand proper security to ensure that the borrower will not only return their capital but also an additional charge. How will the financial resources be utilized? This question is not the basic and decisive factor in extending a loan. In this way financial resources flow either to the rich who can provide the requisite securities or to the Government which is considered to be immune to insolvency. Bank deposits are largely provided by various sections of the society. (It is estimated that eighty percent bank deposits in Pakistan are received from middle class and low income groups of the society).

However, its advantages are largely monopolized by the rich class. The MEC varies according to the sector of investment. So, projects vital to national interest in which MEC is lower than interest rate will not attract investment. A society run on interest will shy away from investing money in those projects in which MEC is low. If interest is abolished investment will be available for every sector and project withoutdiscrimination. VI) Interest and Business The capitalist fixes his share (interest rate) at the time of investment in business.

Since his profit is guaranteed under all circumstances, he has no active interest in the business. He does not care if the business earns profit or incurs a loss. The running of business is entirely theresponsibilityof the management. A class of financiers thus comes into existence who supplies money and then sits idle. If interests are abolished, the financier class will take an active part in the economic struggle and the pace of economic development in the country will be accelerated. VII) Interest and Efficiency Interest has ill-effects on the efficiency of the people in general.

The people who take loans to fulfill private needs are especially burdened with constantanxietyand mentaldepression. This condition has an adverse effect on their efficiency. Their interest in work is half-hearted because they are constantly nagged by the thought that a major portion of their earnings will got to pay the interest. Worry and depression weaken their physicalhealthand their efficiency progressively deteriorates. VIII) Interest and Economic Instability Chapra (2000) states in Tarjuman-ul-Quran that interest destabilize the economy.

The well-known American Economist Milton Friedman relates economic ups and downs to rise and fall in interest rate. A high rate of interest creates conditions of extreme uncertainty in investment market. It causes constant ups and downs in the gross profit (interest + profit) on total investment and makes it very difficult to take reliable decisions about long term investment. IX) Interest and International Loans The capitalist economy is virtually based on loans. So we can call it debt based economy. Individual or home consumption, private or public sector, economic activities in all spheres revolve round interest-based credit.

The Special Issue on Behavioral and Social Science © Centre for Promoting Ideas, USA www. ijhssnet. com 152 During the past two hundred years policies for economic development have used loans not only for physical development but also as instruments for financial expansion. So through credit creation financial expansion has not only been made the most dynamic factor for the economy but has been accorded the greatest importance for achieving economic stability. The developing countries suffer heavy loss due to the dominance of interest-based economic order in the world.

As debtors the developing countries have to tolerate the interference of the advanced countries in their internal affairs. Economically also the developing countries undergo a great loss because a large portion of their meager resources is utilized in returning loans with interest. ALTERNATIVES TO INTEREST Islam not only prohibits interest but also provides alternatives to it for doing business and transactions. These include the Mudarabah and Musharakah as explained ahead. MUDARABAH “ Mudarabah” is a special kind of partnership where one partner gives money to another for investing it in a commercial enterprise.

The investment comes from the first partner who is called “ rabb-ul-mal”, while the management and work is an exclusive responsibility of the other, who is called “ mudarib”. Business of Mudarabah The rabb-ul-mal may specify a particular business for the mudarib, in which case he shall invest the money in that particular business only. This is called al-Mudarabah-al-muqayyadah (restricted Mudarabah). But if he has left it open for the mudarib to undertake whatever business he wishes, the mudarib shall be authorized to invest the money in any business he deems fit.

This type of Mudarabah is called ‘ al-Mudarabah-al-mutlaqah’ (unrestricted Mudarabah) A rabb-ul-mal can contract Mudarabah with more than one person through a single transaction. It means that he can offer his money to A and B both, so that each one of them can act for him as mudarib and the capital of the Mudarabah shall be utilized by both of them jointly, and the share of the mudarib shall be distributed between them according to the agreed proportion . In this case both the mudaribs shall run the business as if they were partners inter se.

The mudarib or mudaribs, as the case may be, are authorized to do anything which is normally done in a course of business. However, if they want to do an extraordinary work, which is beyond the normal routine of the traders, they cannot do so without express permission from the rabb-ul-mal. Distribution of the Profit It is necessary for the validity of Mudarabah that the parties agree, right at the beginning, on a definite proportion of the actual profit to which each of them is entitled. No particular proportion has been prescribed by the Shari’ah; rather, it has been left to their mutual consent.

They can share the profit in equal proportions, and they can also allocate different proportions for the rub-ul-mal and the mudarib. However, they cannot allocate a lump sum amount of profit for any party, nor can they determine the share of any party at a specific rate tied up with the capital. For example, if the capital is Rs. 100000/- they cannot agree on a condition that Rs. 10000/- out of the profit shall be the share of the mudarib, nor can they say that 20% of the capital shall be given to rabb-ul-mal. However, they can agree on that 40% of the actual profit shall go to the mudarib and 60% to the rabb-ul-maal or vice versa.

It is also allowed that different proportions are agreed in different situations. For example the rabb-ul-mal may say to the mudarib, “ If you trade in wheat, you will get 50% of the profit and if you trade in flour, you will have 33% of the profit”. Similarly, he can say “ If you do the business in your town, you will be entitled to 30% of the profit, and if you do it in another town, your share will be 50% of the profit. ” Apart from the agreed proportion of the profit, as determined in the above manner, the mudarib cannot claim any periodical salary or a fee or remuneration for the work done for him by the Mudarabah.

All the schools of the Islamic Fiqh are unanimous on this point. However, Imam Ahmad has allowed for the mudarib drawing his daily expenses offoodonly from the Mudarabah account. The Hanafi jurists restrict this right of the mudarib only to a situation where he is on a business trip outside his own city. In this case he can claim his personal expenses, accommodation, food etc. , but he is not entitled to get anything as daily allowances when he is in his own city.

If the business has incurred loss in some transactions and has gained profit in some others, the profit shall be used to offset the loss at the first instance, and then the remainder, if any, shall be distributed between the parties according to the agreed ratio. Termination of Mudarabah The contract of the Mudarabah can be terminated at any time by either of the two parties. The only condition is to give a notice to the other party. If all assets of the Mudarabah are in cash form at the time of termination, and some profit has been earned on the principle amount, it shall be distributed between the parties according to the agreed ratio.

However, if the assets of the Mudarabah are not in the cash form, the mudarib shall be given an opportunity to sell or liquidate them, so that the actual profit may be determined. There is a difference of opinion among the Muslim jurists about the question whether the contract of Mudarabah can be affected for a specified period after which it terminates automatically. The Hanafi and Hanbali schools are of view that the Mudarabah can be restricted to a particular term, like one year, six months, etc, after which it will come to an end without a notice.

On the contrary, Shafi’i and Maliki schools are of the opinion that the Mudarabah cannot be restricted to a particular time. However, this difference of opinion relates only to the maximum time limit of the Mudarabah. Can a minimum time limit also be fixed by the parties before which Mudarabah cannot be terminated? No express answer to this question is found in the books of the Islamic Fiqh, but it appears from the general principles numerated therein that no such limit can be fixed, and each party is at liberty to terminate the contract whenever he wishes.

This unlimited power of the parties to terminate the Mudarabah at their pleasure may create some difficulties in the context of the present circumstances, because most of the commercial enterprises today need time to bring fruits. They also demand constant and complex efforts. Therefore, it may be disastrous to the project, if the rabb-ul-mal terminates the Mudarabah right in the beginning of the enterprise. Specially, it may bring a severe setback to a mudarib who will earn nothing despite all his efforts.

Therefore, if the parties agree, when entering into the Mudarabah, that no party shall terminate it during a specified period, except in specified circumstances it does not seem to violate any principle of Shari’ah, particularly in the light of the famous Hadith, already quoted which says: “ All the conditions agreed upon by the Muslims are upheld, except a condition which allows what is prohibited or prohibits what is lawful. ” COMBINATION OF MUSHARKAH AND MUDARABAH A contract of Mudarabah normally presumes that the mudarib has not invested anything to the Mudarabah.

He is responsible for the management only, while all the investment comes from rabb-ul-mal. But there may be situations where the mudarib also wants to invest some of his money into the business of Mudarabah. In such cases Musharakah and Mudarabah are combined together. For example, A gave to B Rs. 100000/- in a contract of Mudarabah. B added Rs. 50000/- from his own pocket with the permission of A. This type of partnership will be treated as a combination of Musharakah and Mudarabah.

Here the mudarib may allocate for himself a certain percentage of profit on account of his investment as a sharik, and at the same time he may allocate another percentage for his management and work as a mudarib. The normal basis for allocation of the profit in the above example would be that B shall secure one third of the actual profit on account of his investment, and the remaining two thirds of the profit shall be distributed between them equally. However, the parties may agree on any other proportion.

The only condition is that the sleeping partner should not get more percentage than the proportion of the investment. Now let’s see economy sector vise and analyze both interest based and interest free models. ISLAMIC TAXATION SYSTEM Zakat and Tax Zakat and tax are two systems that are used for the monetary benefits of the people. In this topic we will compare the two systems. Zakat Zakat is one of the five pillars of Islam. The word Zakat means both 'purification' and 'growth'. Zakat occupies a central position in the economic system of Islam.

One of the most important principles of Islam is that all things belong to God, and that wealth is therefore held by human beings in trust. Our possessions are purified by setting aside a proportion for those in need, and, like the pruning of plants, this cutting back balances and encourages new growth. Zakat does not only purify the property of the contributor but also purifies his heart from selfishness and greed. It also purifies the heart of the recipient from envy and jealousy, from hatred and uneasiness and it fosters instead good-will and warm wishes for the contributors.

As Muslims pay the Zakat they have the genuine feeling that it is an investment and not a debit helping to establish economic balance andsocial justicein the society. Compulsory payment of Zakat is one of the main principles of an Islamic economy. Every Muslim who owns wealth more than his needs must pay the fixed rate of Zakat to the Islamic state. Zakat is a means of narrowing the gap between the rich and the poor. It helps the fair distribution of wealth. It is a form of social security.

The Islamic state is responsible for providing the basic necessities of food, clothing, housing, medicine andeducationto every citizen. No-one should have any fear of insecurity or poverty (9: 69, 103, 98: 5). Primarily the root denotes an increase or augmentation (particularly of a positive, favorable or auspicious thing or virtue). Some also say that it means " to purify". However, in the Quran AZKA has been used along with ATHAR in 2: 232. The root, T-H-R (ta-ha-ra) from which the word ATHAR is derived, has the meanings " to purify" but the meanings " to increase, grow, thrive, augment etc. are the primary significations of the root Z-K-W. TAHARA is a negative virtue which signifies being free from dirt, filth or derogatory things. ZAKA is a positive virtue which signifies positive growth and development. The following phrases further clarify the signification of the root Z-K-W. \* Zakat-il-ardh means the land throve or yielded increase \* Zakat-al-ghulam means the boy grew or throve \* Al-ilmo yazkoo Alal infaaq means the knowledge increases by spending \* Zukkoo means he enjoyed or led a plentiful and a pleasant or an easy, and a soft or delicate life.

OR he was in a state of abundance of the goods, conveniences or comforts of life OR he enjoyed a life of increase or plenty. \* Zaka means increase or augmentation or growth or development. The term aatozakaat appears in the following verses: 2: 43; 2: 83; 2: 110; 2: 277; 4: 77; 9: 5; 9: 11; 22: 41; 22: 78; 24: 56; 58: 13; 73: 20; The root of the word Aatoo is A-T-Y (alif-ta-ya), which has the following meanings (depending upon what word or preposition follows this word): • To come (to or over someone) • To arrive (at) To bring, bring forward, produce, accomplish or achieve (something) • To bring, give or offer or provide (someone, something) • To do or perform (a deed) • To carry out or execute (e. g. a movement) • To commit or perpetrate (e. g. a sin or crime) The term aatozakaat is usually taken to mean " give the poor rate" where " poor rate" means" the local tax for the relief of the poor". This definition of the term aatozakaat is not correct and does not bring forth the true and complete concept of the term ZAKA.

The term aatozakaat does not mean JUST to give some fixed sum from the money to the poor,(although it may be a means of accomplishing ZAKA). It is much more than that. Please see the verse 2: 177 in which giving some of the wealth to the near of kin and the orphans and the needy and the wayfarer and the beggars and for (the emancipation of) the captives has been differentiated from the term aatozakaat. Zakat is more than just giving from one's wealth to the poor.

See the following: (2: 177) It is not righteousness that you turn your faces towards the East and the West, but righteousness is this that one should believe in Allah and the last day and the angels and the Book and the prophets, and give away wealth out of love for Him to the near of kin and the orphans and the needy and the wayfarer and the beggars and for (the emancipation of) the captives, and establish SALAT and provide UZAKAU; and the performers of their promise when they make a promise, and the patient in distress and affliction and in time of conflicts-- these are they who are true (to themselves) and these are they who guard (against the inevitable consequences of violating Allah's Commands). Even from the language point of view the term aatozakaat cannot be translated as " give the poor rate". Although Aatoo has one of the meanings " give" but Zakat does not mean " poor rate".

Zakat means increase or augmentation or growth or development. The term aatozakaat is very comprehensive. It signifies "(to) Do whatever it takes to provide the means for the development and growth of all", i. e. "(to) Do whatever is necessary to accomplish the physical and personal growth and development of all". [See the meanings, " do", " accomplish", provide and " achieve" for the word Aatoo given above]. The purpose of Aatozakaat is to provide the means of development for all. It includes physical development and nourishment as well as development of the humanpersonalityi. e. mental/intellectual/personal development or development of the " self".

Development of human hardware as well as human software It involves development, increase and augmentation in the produce and resources to provide abundance of goods, conveniences and comforts to people as well as their self-actualization or development of their personalities. It is a complete economic system that ensures the provision of all the requisite resources for the physical and personal development of people. In order to establish such a system you have to have authority, power, dominion and government. If you already have such an authority and you are an Islamic Government, your primary task is to establish such a system. Please see 22: 41. 22: 41 (Believers are} those who, if We establish them in the land, establish SALAT and provide ZAKA and enjoin good and forbid evil: ...

Notice in the above verse, the establishment in the land has been described as a prerequisite for the system of ZAKA. As has been mentioned above that growth and development is of two types: Physical (i. e. of the human hardware or body) and Personal (i. e. of the human software or the self or the personality). For physical development you have to have something added to your body as nourishment but for the development of the self or self-actualization, you need to give something out of your wealth or resources for others. See the following verses (which state that TAZKIYA or personal development is achieved by giving from your wealth to others: 9: 103 accept their contribution for the community.

Purify their thoughts with proper education and training so that their " Self" may grow. Appreciate and Help them! Your appreciation and support is a great source of peace in their hearts. Allah is Hearer, Knower 92: 18 Who gives his wealth (for the benefits of others) so that he may attain self-development (and grow in goodness). FUNDAMENTALS AND CONCEPT OF ZAKAT Zakat " alms for the poor” is the Islamic principle of giving a percentage of one's income to charity. It is often compared to the system of tithing and alms, but it serves principally as the welfare contribution to poor and deprived people in the Muslim lands, although others may have a rightful share.

Zakat's similar-sounding, Arabic language analog is the Hebrew word Tzedakah, the charitable obligation in ancient Israel through to present day Judaism. It is the duty of the Islamic state not just to collect Zakat, but to distribute it fairly as well. Zakat is one of the Five Pillars of Islam. Believers in Islam are aware that by giving a fixed percentage of their surplus wealth, they are fulfilling this religious obligation. Muslims see this process also as a way of purifying themselves from their greed and selfishness. In addition Zakat purifies the person who receives it because it saves him from the humiliation of begging and prevents him from envying the rich.

Causes & Beneficiaries The Qur'an states that God revealed the beneficiaries of Zakat:" Alms are only for the poor and the needy, and the officials (appointed) over them, and those whose hearts are made to incline (to truth) and the (ransoming of) captives and those in debts and in the way of Allah and the wayfarer; an ordinance from Allah; and Allah is knowing, Wise. " [Qur'an 9: 60] The people whose hearts are to be reconciled include (normally new Muslims or those close to becoming Muslim. Non Muslims cannot be included): • Freed slaves • Those heavily burdened with paying their debts • Travelers who find themselves in difficult circumstances

There have been cases where you can't pay to the Zakat for • Traditional Zakat laws generally do not cover trade. • It is not permissible to pay Zakat to some members of thefamily(i. e. grandparents, parents, spouses, children), for if they were needy or poor, they are under the custody of the eligible man, while Zakat is intended for public welfare. •Zakat doesn't become obligatory on a Muslim if he doesn't have a minimum amount in his possession that has remained unchanged for a whole lunar year; any increase in that money during the year waits for the following year and any decrease as long as the total amount is still above the minimum amount is exempted.

In all the four recognized madhhabs the Fiqh of Zakat is very much the same with the key elements that make Zakat compulsory for an individual being: Islam, Freedom, the Nisab, Ownership and a Year's Possession. Zakat is a form of payment, which has the spiritual development of the believer. Therefore, it should not be looked at as being only an economic duty. On Whom Zakat Is Compulsory Zakat is the amount of money that every adult, mentally stable, free, and financially able Muslim, male and female, has to pay to support specific categories people. This category of people has been defined above. MINIMUMS AND AMOUNTS 1. Passage of One Lunar Year

Zakat is obligatory after a time p of one lunar year passes with the money in the control of its owner. Then the owner needs to pay 2. 5% (or 1/40) of the money as Zakat. (A lunar year is approximately 355 days). 2. Deduction of Debts The owner should deduct any amount of money he or she borrowed from others; then check if the rest reaches the necessary Nisab, then pays Zakat for it. Nisab for Zakat If the owner had enough money to satisfy the Nisab at the beginning of the year, then the money increased (in profits, salaries, inheritance, grants... etc. ), the owner needs to add the increase to the Nisab amount owned at the beginning of the year; then pay Zakat, 2. %, of the total at the end of the lunar year (there are small differences in the Fiqh schools here). Zakat is not mandatory on harvest if the total did not reach the minimum limit of about 653 kilograms, nor on gold amounts if the owner has less than 85 grams of gold or less than 595 grams of silver. Calculation of Zakat Each Muslim calculates his or her own Zakat individually. For most purposes this involves the payment each year of two and a half percent of one's capital. Zakat in the Qur’an and Sunnah A. The root of the word Zaka(t) is Z-K-W (za-kaf-waw), which leads to the following meanings: • To increase • To grow • To thrive • To augment • To increase in the purity of heart; to increase in integrity • To befit

The following points will explain calculation methods of Zakat in different situations: B. There are different opinions about this. However, the general opinion is that jewelry, whether it is normally in use, or stored for occasional use, must all be included in calculating Zakat. The value of the gold or silver content in the jewelry should be included in the category of " Personal wealth". Precious stones (diamonds, ruby, pearls, etc) are not to be included neither the labor cost of making the jewelry is to be included. Zakat on precious stones, however, is due if they are items of trade and should be included in Item 6, business inventory. C.

Though owning a share of stock of any business is like having a share in the ownership of the business; we have categorized it as " Personal wealth". Therefore, the lower of the value of stock at the beginning and the end of the year should be added in the category of " Personal wealth". This is categorized as " Personal wealth" because of two reasons. 1. For the most people who own stock it is held as a saving with expectations that it will grow in value over time. In fact it is readily traded for money. Considering it as a readily redeemable asset, we have treated it as another form of saving. Therefore, we suggest using its fair market value in calculating Zakat. 2. Calculating Zakat on stock treating it as a share in ownership is normally not very convenient.

There are literally millions of shares owned by general public. A stockholder will need to know his/her share of cash on hand, profit, and inventory, in order to use those values in the calculation of Zakat. This information is ordinarily very difficult to obtain, unless it is a partnership of a few people. Therefore, we did not treat stocks as a business partnership. D. If this amount is available to the individual at any time without any restrictions, then Zakat should be calculated for this amount through the category of " Personal wealth" because its nature will be that of savings. If the plan is restrictive and involves penalty and/or taxes, opinions differ on the payment of Zakat. 1.

One opinion is that an