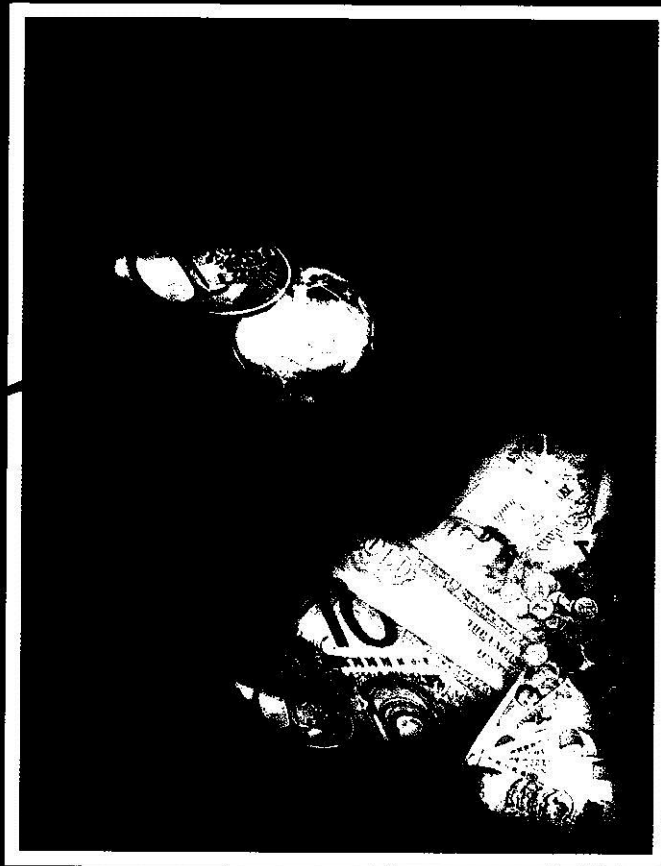


Financializing Development
of Financial Instruments

by

Dr. Md. Wajid Faruk Hanafi, Integration

| Souvenir & Proceedings of Papers |

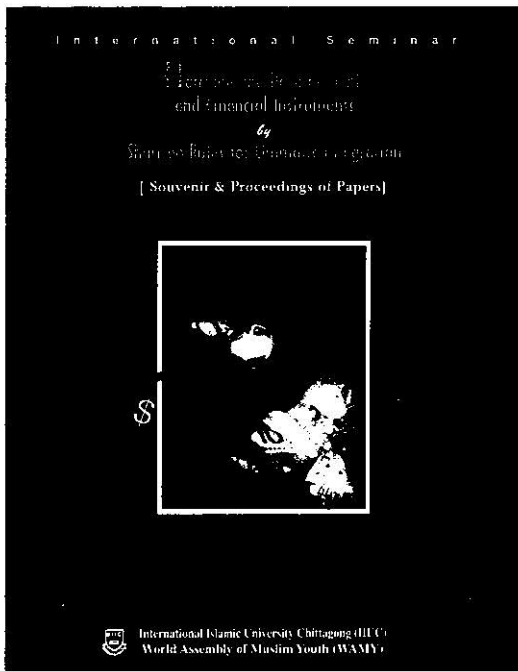


International Islamic University Chittagong (IIUC)
World Assembly of Muslim Youth (WAMY)

Harmonizing Development and Financial Instruments
by
Shari'ah Rules for Ummatic Integration

Souvenir

International Seminar



Date:

19-20 December 2004

Venue:

Safa Arcade, Chittagong
Bangladesh

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International Islamic University Chittagong (IIUC)
World Assembly of Muslim Youth (WAMY)






EDITORIAL NOTE

The International Seminar on Harmonizing Development and Financial Instruments by Shari'ah Rules for Ummatic Integration is a first of its kind for invigorating the consciousness of the Muslim World towards positive thinking and action in social, institutional, economic and global integration of the Muslim World. The conscious Muslim World is the Ummah. It therefore has vibrant inner and outer lives. The Ummah interacts within itself as well as with all other. The International Islamic University Chittagong along with the co-sponsor, World Association of Muslim Youth is to be commended for hosting this momentous event. This august assembly, which is gathering participants from different parts of the world and who will deliberate in this major event is also a significant event. The Muslims of Bangladesh in particular and of the World should be expecting some significant outcome from this major intellectual event. True, the theme and approach of the conference are directed towards this end for a positive intellectual and operational rapport on the theme. This would embrace both the nature and application of the tenets of the Islamic world-system.

Islamic resurgence in recent times, which is gathering momentum everywhere, is a result of many forces. There is growing constructive intellectual thinking at the academic and institutional levels and sheer interest by all regarding the nature of Islam and the modern world. The search for knowledge and the rarity of the message of such constructive depth in Islam and the world-system has always been there in the annals of history. But it gathers fresh momentum at the turn of critical junctures. New thinking not only in the architecture of globalization and its social, economic and institutional consequences face the modern world. Rather the modern world is also theatre of quest for newer ways of understanding the scientific mindspace.

The modern world has been changed in every way. There is the mark of dismay and distrust coming from the most unexpected quarters -- of material plenty, civil society and the high pinnacle of science. None of these has established sustainable human futures. The weight of war, pestilence, oppression and deceit subdues the world as never before. Such human demise is all the more unacceptable when we find its origin in the wealthiest of the nations and superpower. It is further conflagrated by the institutions of global command, control and governance and by such national stereotypes. The world would have instead expected human futures and co-existence emanating from collective discourse and goodwill in and among the comity of nations.

Islam is the divine conduct of life centered on universal empathy as it emanates from the Mercy of Allah with the Prophet Muhammad as Allah's Mercy to all the worlds. The world-system of Islam in all its details is thereby entrenched in such a model and global relationship of empathy.



Its epistemological foundation carries the power of divine knowledge of oneness across space, time and abstractions. The consequences of such a foundational premise for human organization, behavior and thus life and thought reflect and implement empathy in all that Islam touches. And there is nothing that is left out of the divine touch of oneness through Islam.


In this international seminar we should be looking for new thinking and bold ways of discovering and harmonizing the instruments of Islamic Law, the Shari'ah, toward realizing unity of the human order in the light of the epistemological outlook of unity of the divine law as it works in the living world-systems. This is a venue for interaction and consensus followed by dynamic co-evolution of the mind and matter universe. That is, we are welcoming a healthy participation between the intellectuals and the practitioners to lay the working models of an Islamic world-system that embraces revolutionary foundationalism as well as application. We must discourse such issues in the light of what presently prevails in the power and defeat in the midst of human alienation, the war machine and globalization and contrarily construct what can be rendered as a comprehensive and sustainable worldview to the comity of nations. Through the power of knowledge and unity of the world-systems we ought to look for the destruction of the power of evil that has been unleashed in the world today by those in the war machine and global command, governance and control.

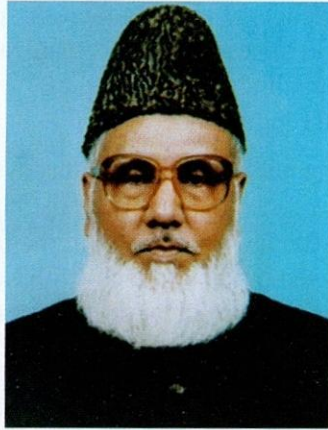
Harmonization of development and financial instruments by the Shari'ah rules for Ummatic integration also means dismantling the subservience of the Muslim mind to discord over religious trifles and rejecting the unquestioned acceptance of alien scholarship to Islam. Thus harmonization calls upon Muslims to unite under the banner of the only power and wisdom that can truly unify. This is the universal foundation of oneness of Allah and its application to the understanding and explanation of all issues and problems that define life. But the message of Islam as the worldview of unity of knowledge extends beyond narrow domains into extensively embedded orders. Within these, the Islamic worldview is a message to all of humanity and to all the worlds in the light of the unity of divine knowledge. The Qur'an refers to such systemic unity of knowledge, life and thought as Tawhid. The Qur'anic world-systems are referred to as 'Alameen.

The venue of this august assembly should give us the occasion to search for truth premised on the fundamental premise of Tawhid and to look for its application in the development of thought and the world-systems. The latter is the essence of a discursive global society that the Qur'an presents in its model of solidarity, participation and complementarities of being. This learning medium is called the Shura (consultative participation). But the Shura is connected with the embedded truth of oneness of Allah in world-systems. Such a unity of being is unraveled through extended application of the Shura as intellection process. The phenomenon of understanding the semiosis of the meta-scheme of things is the Qur'anic Tasbih. Thus the model of unity of world-systems in the light of the divine law presented by the Qur'an, the Sunnah and a discursive medium (Ijtihad) is that of Tasbih-Shura understood and applied as learning process.

Let us discourse this T-S model and it's meta-application in the issues before us.

Professor Dr. Masudul Alam Choudhury
University College of Cape Breton
Sydney, Nova Scotia, Canada &
International Chair, Postgraduate Program in
Islamic Economics and Finance
Trisakti University Jakarta, Indonesia





Minister
Ministry Of Industries
Government of the People's
Republic of Bangladesh

Message

Bismillahir Rahmanir Rahim

I am happy to learn that the International Islamic University Chittagong (IIUC) in collaboration with the World Assembly of Muslim Youth (WAMY) Dhaka is going to organize an International Seminar on Harmonizing Development and Financial Instruments by Shari'ah Rules for Ummatic Integration on December

19-20, 2004 at Safa Arcade, Chittagong. It is undoubtedly a timely and praise worthy initiative. I do congratulate all those who are involved in organizing such a seminar of vital importance.

The Seminar is being organized at such a time when the concept of interestfree resource mobilization at the grassroots and Shari'ah based Islamic modes of

participatory and custom-tailored financing program for alleviation of poverty and economic progress are getting well recognized not only in Bangladesh but also in other Muslim and Western countries as well. Not only Muslim scholars, academics and practitioners but also the common people including the people of other religions and different walks of life is now in a mode to welcome the better practices. As a complete code of life, Islam and its Shari'ah can offer not only for the Muslims but

for the entire humanity, the better and best practices and modes for all aspects of human lives and its Muamalat including trade, commerce, economic and financial transactions. For this, what is needed is the intellectual interaction, investigation, deliberation, exchange of ideas and views, sharing each other's knowledge and experiences in the respective fields within the framework of Shari'ah.

I am confident that in this seminar eminent scholars, academics, experts and practitioners participating from both home and abroad would deliberate, exchange and share their respective ideas, views, knowledge and experiences on the subject of the seminar with special emphasis on how the existing and new Islamic instruments be further developed and harmonized by Shari'ah rules to achieve Ummatic transformation. I hope, this seminar will produce practical recommendations that can help in proper planning and progress towards achieving the coveted goal of the seminar.

I wish the seminar a grand success.

Motiur Rahman Nizami, M.P.



PROFESSOR DR. A. K. M. AZHARUL ISLAM
VICE-CHANCELLOR
INTERNATIONAL ISLAMIC UNIVERSITY CHITTAGONG

Message

I take much pleasure in welcoming so many foreign academic guests and practitioners who have joined our national ones to deliberate, interact and learn on a theme of critical importance today in the world. This is true for not only for the Ummah, but also for the rest of the World along with the Ummah, the conscious world nation of Islam. It is most pertinent that such an august occasion is being sponsored jointly by the International Islamic University Chittagong and the World Association of Muslim Youths (WAMY) on December 19 & 20, 2004.

Islamic Law or the Shari'ah rules on designing and implementing an economic order, financial instruments and a new business-finance-monetary architecture enter the world scene with full force at this critical juncture of preponderant economic crisis, financial volatility and human deprivation gripping the world today. Yet the details of both the scientific and practical aspects of the Shari'ah instruments for realizing overall integration of the Ummah vis-à-vis the global order need to be vetted out through the medium of discourse in the spirit of inquiry (Ijtihad) that derives from the fundamental sources of the Qur'an and the Sunnah, while enabling human participation to unravel such constructive rules. This International Seminar on Harmonizing Development and Financial Instruments by Shari'ah Rules for Ummatic Integration is a much-needed occasion for intellectuals and practitioners to come together to discourse some major issues around the conference theme.

I hope that this first experience of a distinctive and most significant nature will carry its message far and wide and pave the path for continued evolution of the Ummah in areas of mutual prosperity and wellbeing with the rest of the world. I hope also that the Center of Comparative Political Economy within the center of excellence at IIUC will take upon itself the task of cementing and enhancing efforts beyond this intellectual venue for the common purpose.

I wish the seminar a grand success, which it rightly deserves.

(Professor Dr. A. K. M. Azharul Islam)



Professor Dr. Abu Bakr Rafique
Convener, Seminar Organizing Committee
Pro-Vice Chancellor, International Islamic University
Chittagong

Message

It is a momentous occasion in the intellectual and practitioner lives of Chittagong and Bangladesh to host this important conference on the theme of integrating the Ummah by use of the unity of belief and action with participated togetherness. Thus I take this occasion to welcome all of you to actively participate in this important occasion. During these two days let us look forward to deliberate, interact and establish pedestal for future sustained progress towards cementing the Muslim ranks in respect to their common social, economic and institutional matters.

The essence of “Harmonization of development and financial instruments by Shari’ah instruments for Ummatic integration” is to excite and bring together a future conscious world-nation of Islam called the Ummah into a constructive and participatory fold of collective thinking and action.

Today, the Ummah remains fragmented and easy prey to inimical forces against Islam and Muslims. This opposition to Islam comes both from within as well as outside the Muslim World. Within the Muslim World there is lack of harmonized thinking along lines that otherwise ought to be truly Islamic in the light of the Qur’an and the Sunnah. Subsequently, such an authentic thought process ought to become a paradigmatic revolution within an Ummah and also across all humanity. Such a newly founded synergy of Islam ought to become the foothold of original thinking and practical application for the construction of instruments that will raise the edifice of the Islamic world-system.

The essential path of guidance in the Islamic worldview is centered in oneness of the divine law as commanded by the Qur’an. This is followed by the support of the Sunnah and carried forward by Islamic discourse called Ijtihad through Islamic consultation and participation process called the Shura.

Harmonization of development and financial institutions by Shari’ah rules is primarily to discover the Qur’anic roots of the world-system, further supported by the Sunnah and Ijtihad through a process that is pervasively unitary and participatory in nature. In the sense of systems, we interpret the divine law of oneness of Allah as the pervasively complementing law of organic unity between the goods things of life. False beliefs and their artifacts are recognized as unwanted edicts of a disintegrated domain of illogical formalism, contest and conflict of various forms. The intellectual enterprise and practice of the Islamic worldview of systemic unification premised on the unity of knowledge in the divine law is the distinctive mark of the Islamic worldview.

I am proud and fortunate to be a part of this deeply thought conference theme. I want to see that this venue succeeds in its sincere endeavor and underlying perspective.

Professor Dr. Abu Bakr Rafique Ahmed





COUNTRY DIRECTOR - BANGLADESH
WORLD ASSEMBLY OF MUSLIM YOUTH (WAMY)

Message

It is my great pleasure as the country director of WAMY to participate with the prime institution, the International Islamic University Chittagong in organizing this very august occasion of the International Seminar on Harmonizing Development and Financial Instruments by Shari'ah Rules for Ummatic Integration. The theme enters the world intellectual and practitioner scene at a time when the shape of things to come point unfailingly to the rise of the Islamic worldview. Islamic worldview is certain to dawn in the hearts and minds of all - Muslims and others alike. The character of empathy of Muslims towards themselves and others will bring this about. It will also be realized through the truly Shari'ah understanding and implementation of such worldly instruments (Muamalat) that enable stability, prosperity and wellbeing for all as universal balance (Mizan).

It is also heartening to note that so many foreign scholars have joined national scholars and practitioners to interact and learn from this learned forum for the evolving order of the Islamic transformation, which is the Ummah. Thus in the global world we are examining the importance and distinction of the Islamic worldview upon a new framework of relationship involving Muamalat. There is much to learn, deliver and implement from such an interactive holism for Muslims and others alike.

I am also encouraged to find that there is a Center of Comparative Political Economy (CCPE) in the center of excellence of IIUC. Such a center should receive all possible support to carry the task of advancing the Islamic worldview in the fields of Muamalat and scientific thought.

I wish the seminar a grand success in the name of Allah.

Murad Abdul Hadi Shahin





From the Desk of Member Secretary

All praises to Allah (swt) who enabled us to organize the International Seminar on "Hermonizing Development and Financial Instruments by Shari'ah Rules for Ummatic Integration". This seminar was supposed to be held in the year 2003. But for many a reasons it was deferred to the end of 2004. Last year, a seminar of the same nature was held in Trisakti University, Jakarta, Indonesia.

I would like to mention here, name of the great scholar, Professor Dr. Masudul Alam Chowdhury, Director General of Centre for Comparative Political Economy (CCPE) of IIUC who engineered this seminar taking all the pains to contact and finalize the paper presenters from all over the world.

International Islamic University Chittagong (IIUC) authority deserves special thanks for their support by approving the centre to execute the program, giving financial and needful logistic support. World Assembly of Muslim Youth (WAMY) Bangladesh office extended their all out cooperation to materialize the seminar. Seminar Committee is grateful to them too. Islami Bank Bangladesh Limited (IBBL), T.K. Group and Noman Group helped us to make the program a success.

The Seminar is going to be attended by reputed Islamic thinkers, economists, bankers, insurance company executives, professionals and students. This seminar will provide the participants opportunity to interact with intellectuals on economics and finance from home and abroad, to have practical orientation with theoretical exchanges.

Members of the organizing committee, different sub-committees, volunteers and our colleagues at IIUC worked hard in making the program worthy.

Since we started International Institute of Islamic Political Economy and Interactive Systems (IIPEIS) in 1997 which was the first centre on Political Economy in Bangladesh, we organized two workshops and one International Seminar. This seminar is a follow up of those programs organized earlier. We hope this seminar will make awareness among the people regarding Ummatic Integration in two very important fields Economics and Finance.

Thanks again to all our guests specially Chief Guest, Mawlana Motiur Rahman Nizami, Minister for Industries for gracing the program with his kind presence, all the participants, presenters, discussants, co-workers and colleagues.

(A.Z.M. Obaidullah)

Member Secretary

Seminar Organizing Committee

Director, STAD, IIUC



Innaugural Session

19th December 2004, Sunday, 9.30 A.M.~11.00 A.M.
Safa Arcade, Chittagong, Bangladesh

Chairman _____

Professor Dr. A.K.M. Azharul Islam
Vice-Chancellor
International Islamic University Chittagong

Chief Guest _____

Mawlana Motiur Rahman Nizami
The Honorable Minister of Industries
Government of the People's Republic of Bangladesh

Special Guest _____

Mr. Shah Abdul Hannan
Chairman
Islamic Economic and Research Bureau

Invited Guest _____

Mr. Murad Abdul Hadi Shahin
Country Director-Bangladesh
World Assembly of Muslim Youth (WAMY)

Business Session : 1

KEYNOTE LECTURE

19th December 2004, Sunday, 11.15 A.M.~1.00 P.M.

Professor Masudul Alam Choudhury
School of Business, University College of Cape Breton
Sydney, N.S. Canada
&
International Chair
Postgraduate Program in Islamic Economics & Finance (PPIEF)
Trisakti University Jakarta, Indonesia

INTRODUCING THE THEME:

The Dynamics of the Shari'ah and World-System

THE DYNAMICS OF THE *SHARI'AH* AND THE WORLD-SYSTEM

Professor Dr. Masudul Alam Choudhury

University College of Cape Breton
Sydney, Nova Scotia, Canada
Director General, Centre of Comparative Political Economy, IIUC
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ABSTRACT

The topic of Islamic worldview versus neo-liberalism is discussed. The epistemology of unity of divine knowledge called *Tawhid* in the *Qur'an* as the basis of the Islamic future is contrasted with that of self-interest and individual sovereignty in liberalism. The methodology underlying the *Tawhidi* worldview as the overarching formalism of unifying world-systems is explained. Premised on this universal methodology of systems-based unity of knowledge the creative co-evolutionary process model involving knowledge-flows and knowledge-induced entities of world-systems is explained. The example of capitalist globalization as the offshoot of neo-liberalism is contrasted with the demands and organization of the Islamic world-system called the *Ummah*. The alternative framework of *Ummatic* globalization in contrast to capitalist globalization is suggested. Some of the underlying artifacts of this momentous change, particularly the money-finance-real economy complementary linkages according to the systemic unity of *Tawhidi* knowledge and using the instruments of the *Shari'ah* are examined. The dynamics of the *Shari'ah* is explained in terms of the *Tawhidi* worldview in contrast to how the framework of the *Shari'ah* is understood by the prevalent Muslim mind far away from an endogenous functioning of the *Tawhidi* episteme in it. Prevalent thinking in Islamic economics, finance, science and society is critically examined against the backdrop of the *Tawhidi* methodological worldview. The paper concludes with relevant policy prescriptions.

Backdrop of the theme

The backdrop of this paper is a view of the *Ummah* in contrast to capitalist globalization. Two initial conceptions must be explained, namely of liberalism that grounds Capitalist Globalization and the *Shari'ah* that grounds the *Ummah*. Following this contextual commencement of this paper, the objective of this paper will follow.

We raise the questions whether the capitalist globalization process, which confronts the world today in all entirety, is really the last epoch of the human race? Or is the capitalist globalization a challengeable idea and replaceable by an alternative context of globalization in the context of an ethical and moral world order?

If the answer to the first question is in the affirmative then we will argue that the human race is in the precincts of ever-widening perils of social and ethical deprivation. The end of history would then mean the gradual extinction and impoverishment of many by the yoke of affluence and inequality globally speaking of a few. While the economic problems of a fortunate section of mankind may be solved, yet these will continue to be a dark reality at an immense cost of social and political deprivation for many. The final result of the end of history would then be a cataclysmic event of global entropy.

On this global entropy writes Korten (1996, p. 11)

The continued quest for economic growth as the organizing principle of public policy is accelerating the breakdown of the ecosystem's regenerative capacities and the social fabric that sustains human community; at the same time, it is intensifying the competition for resources between rich and poor – a competition that the poor invariably lose.

Heilbroner presents his dark views on the human prospect (1991, p. 11):

There is a question in the air, more sensed than seen, like the invisible approach of a distant storm, a question that I would hesitate to ask aloud did I not believe it existed unvoiced in the minds of many: "Is there hope for man?"

On the specter of the economic future of mankind Keynes wrote (1963, p. 319):

... I may do well to remind you, in conclusion, that the fiercest contests and the most deeply felt divisions of opinion are likely to be waged in the coming years not around technical questions, where the arguments on either side are mainly economic, but around those which, for want of better words, may be called psychological or, perhaps, moral.

If the answer to the second question posed above is in the affirmative, then the problem posited by the first question is negated and a new vision of the future arises. We then enter a discursive medium of combating the prognosis of capitalist globalization by a moral and ethical alternative. The elements of this new regime of social transformation is a massive normative question that embraces momentous changes in the ideals, praxis and enactment of the vision of a globally acceptable ethical and moral precept that must supercede all issues of life that global exchange and partnership embraces for common human wellbeing. Is this normative issue Utopia or a fundamental reality? If we can successfully explain that this vision of the future is indeed a reality then the specter of capitalist globalization is unreal in the sense of its unsustainability in the history of the future.

Henderson (1999, p. 56) puts this contrasting picture between human wellbeing and capitalist globalization succinctly:

The good news is that this (capitalist globalization) is forcing us to "go inside ourselves" and ask some pretty basic questions: What do I *want* to pay attention to? Who am I and what do I want written on my tombstone? Such basic defensive reactions will define the growing sectors of our

Attention Economics and their inexorable shift from material goods (measured by traditional GNP/GDP per capita), to services and more intangible factors in living standards, measured by the new Quality of Life scorecards.

Objective

The thesis we want to propound here is that with the new wave of thinking that post-modernity is bringing with it, there is a parallel and powerful rise of a unitary and symbiotic way of thinking and organizing life that emanates solely and wholly from the Islamic worldview. This is a theme that we will take up here in respect to organizing an alternative paradigm of globalization in which global ethics and morality are not only central to the human prospect but also usher a structurally novel way of looking at the world. This way has always been there at the heart of historicism, but it gains momentum at the turn of every critical juncture, which in this case is the new millennium. We will argue that the end of history is indeed this historically established human future premised on the unitary prospect of life and its organization. Elsewhere (Hossain et al 1998) we have called this historical turning point as 'reversible entropy' of the socio-scientific order.

Contrasting paradigms in globalization

Some coterminous problems arise in examining the structure of capitalist globalization. These are contrasts centered on the liberal philosophy of thought that drives capitalist globalization on the one hand. On the other hand the inexorable opposition to liberalism is raised by none other but Islam. Thus a new epistemology drives Islam that being opposed to liberalism is also contrary to capitalist globalization. It is the conflict between these two opposed episteme of the world order that is marking the rise of Islam-West divide in today's world-system. These are the contrasting paradigms of the end of history and the last man (Fukuyama 1992). Islam is a morally centered vision of human future where all world-systems converge in a unified field of consciousness. Contrarily, the liberal mind of Occidentalism marks the entropy order of capitalist globalization.

Liberalism is entrenched in individual sovereignty. Freedom and liberty of thought and action in liberalism belong to the untrammelled presence of the individual as the ultimate arbiter of a self-centered decision-making. In this framework, the corresponding constitutional framework of nations, polity and civilization exerting economic, social and political legitimacy is defined by the extension of the liberal mind over these macro-levels (Minogue, 1963). The same character of self-interest, conflict, competition and hegemony of self now extended to the macro-level govern the institutions of markets, polity and ethical social norms.

James Buchanan and Gordon Tullock (1999) explained the liberal constitutional social contract in terms of methodological individualism collectivized by its supporting polity, institutions, markets and social order to reign as the hegemony that enforces liberalism on the world-system. There is no innocent way by which liberalism has thus spread through the world-system. Contrarily, such a hegemony was enacted through the praxis of methodological individualism enforced by political power, economic governance and a mindspace of self over other. James Buchanan (1999 op cit, p. 391) writes in this regard, "Concomitant with methodological individualism as a component of the hard core is the postulate of rational choice, a postulate that is shared over all research programs in economics."

On the nature of constitutional economics Buchanan (op cit, p. 390) writes.

For constitutional economics, the foundational position is summarized in methodological individualism. Unless those who would be participants in the scientific dialogue are willing to locate the exercise in the choice calculus of individuals, *qua* individuals, there can be no departure from the starting gate. The autonomous individual is a *sine qua non* for any initiation of serious inquiry in the research program.

Buchanan sounds the end of any possible scientific dialogue between the opponents of methodological individualism and the school of liberalism in the occidental worldview. The individualism of the liberal order remains neutral to the so-called rational choice between alternatives by ignoring whether these are 'good' or 'bad'. On this matter Buchanan (op cit p. 391) writes, "The test for individual rationality in choice does require, however, the minimal step of classifying alternatives into *goods* and *bads*."

The inadequacy and failure of the liberal order in addressing matters of ethics, morality, culture and values is sounded in Buchanan's (op cit. p. 394-95) words: "The domain (constitutional economics), as such, cannot be extended to include inquiry by those who choose to perceive social interaction differently. There is simply no common basis for scientific argument, and ultimately agreement with those who choose to perceive social interaction either in purely conflictual or purely idealistic visions."

Globalization and the world-system in the paradigm of liberalism

Globalization meant as networking of ideas emanating from liberalism and crystallized into organization, governance and its consequences in the domains of self in relation to economy, corporation, technology and supra-developmental policies and controls by powerful organizations and nations, is a medium that carries the liberal philosophy to its limit. In this context of its neo-liberal structure globalization is not tantamount simply to issues of free and competing markets exchange, trade liberalization, capital flows, technology transfer and organization of development and growth menus in line with the policies and conditionalities imposed upon members by development financing organizations. More extensively, through all these instruments of the global change globalization means entrenchment of the philosophy of liberalism into all nations that intend to be members of the capitalist globalization process.

Sklair (2004, p.84) writes on globalization as a networking process for sustaining liberalism:

"Globalizing processes are abstract concepts, but the transnational practices that create them refer directly to what agents and agencies do and derive meaning from the institutional settings in which they occur, and because of which they have determinate effects." The multinational corporations act as medium for mobilizing the conceptual space of neo-liberalism and neo-mercantilism. Sklair refers to such a transformation of the neo-liberal idea into the domain of global capitalism as the conceptual space for transnational practices (TNP).

Money-Real Economy relationship in the liberal paradigm

Capitalism presents a relationship between money and the economy that remains indelible in all the relations, preferences, practices and policies involving the economy, markets and economic policy. Heilbroner (1985) explained this endemic causality between money, capital formation and the economic transformation in terms of Marx's MCM relationship. This can be explained briefly as follows:

A quantity of money (M) as fiat money is commodified (C) through the process of saving in response to interest rates. This saving then enters the time-lagged production process to cause the money held through savings to be mobilized partly into the real economy while the greater part of the savings continues in the liquid form as long as interest rates as the return on money remain attractive to the savers. This process of commodification of money followed by the emergence of more money can be explained by the simple cycle.

M0(initial quantity of money)

= M01(real money) + M02(money in the form of papers)

→savings

= [C01 (resource mobilization into real economy) + C02(saving in financial papers)]

→ M11(monetary growth by real returns) + M12(monetary growth by interest rates).

In the above schema, the part represented by **M01 → C01 → M11** is a purely resource mobilization channel that links money to the real economy. By this portion of the economic transformation is realized the participation of productive labour in economic activity. But this sequence also requires spending in the good things of life in order to qualify for both purposeful work efforts and mobilization of other productive factors that are complementary to labor. Thereby, participation increases in the purposeful social and economic contexts. This causes the relevant form of productive technological transformation, empowerment and growth of entitlement to take place. In this context, saving is purely a form of resource mobilization as money and real economy are complemented together causing productive utilization of factors, the advancement of technological change and social wellbeing.

The portion **M02→C02→M12** is caused by withholding of financial capital in the form of idle savings, that is papers. As long as this form of saving continues money is severed from its complementary linkage with the real economy. Consequently also the productive capacity of the economy and the social wellbeing suffers.

While productive agents are the beneficiaries of the money-real economy linkage, those of the second category form property and property rights of the capitalist masters. Such a capital accumulation gives rise to large financial organizations and speculative capital markets, portfolio investments as opposed to foreign direct investment and the ensuing overall instability.

Capitalist globalization is entrenched in the above form of a dichotomous MCM relationship between the use of money for direct productive and socially rewarding activities and its use as paper money for the growth of more money through the process of capital accumulation. The latter form of capital accumulation is based on savings pursuing interest rates. It thereby institutionalizes the holding of financial capital. At the end, in the light of the scarcity assumption of all of economic theory, the marginalist tradeoff between the real economy and the saving economy partitions financial flows between these activities in perpetuity. Capitalism cannot get out of this continued form of allocating financial resources between the two competing ends according to the scarcity picture of resources. By doing so, capitalism perpetually must promote inequality, loss of productivity, social wellbeing and cause perpetual instability due the volatility of the financial sector in response to speculation and the growth of interest-based financial papers. The last point is established by noting that the short and long run rates of interest are term of structures of multitudes interest rates that move randomly in different portfolios.

What is the status of entrepreneurial capitalism in the capital accumulation process on which Schumpeter (1961), Hayek (1990) and Weber (1947) wrote their prolific pieces? Entrepreneurial capitalism is a process of innovation premised on continuous innovation by the rise of human creativity. Nothing is static in this process as creative destruction defines the perpetual causation of

an evolutionary paradigm of innovation and development. Capital formation as a process is realized out of such an evolutionary process of converting money capital into real capital. Yet what is the problem with the theory of entrepreneurial capitalism?

The assumption of scarcity of resources, economic competition and rational choice behaviour continue on to mark the human spirit and the human ego of reason (von Mises 1976). Consequently, the liberal axiom of individual sovereignty remains intrinsic to these Austrian economic doctrines. The combination of the scarcity, competition, and rational choice assumptions once again reverts to maintaining the economic marginalist tradeoff doctrine of substitution instead of complementarities between alternatives. Thereby, savings (as opposed to resource mobilization) and the real economy once again substitute each other in the resource allocation doctrine of the marginalist way of economic reasoning. Hayek (1999) in his *Good Money* brings out this belief on the prevalence of the marginalist school of the neoclassical genre.

The liberal entrenchment in capitalist globalization

The theme of the end of history according to capitalist globalization paradigm can now be summarized by the following schematic design of entrenchment of the liberal epistemology in the capitalist world-system (Wallerstein, 1980):

Liberalism

→ [Markets, Economy, Science, Society, Technology, Global Hegemony](liberalism)

→ World-system as totality of the above system of transnational relations

= Capitalist world-system

→ Capitalist Globalization.

Since the above schema is universally intrinsic to capitalist globalization, therefore the differentiated forms of the society, economy, polity, and value relationships remain the permanent characteristics of global relations under liberalism. With this kind of systemic permanence of global capitalism the picture of the human future under capitalist globalization is one of conflicting polarity between differentiated parts of the human order. Such a competition results in the loss of the social worth of human existence premised on self-actualization caused by the growth of consciousness. Sztompka (1991, p. 94) explains the role of consciousness in social realization as follows: Consciousness "leads us back to the central claim: what truly exists in society, in the full ontological sense, is the *unified socio-individual field*, the 'third level of reality' between traditionally conceived levels of totalities and individualities."

Capitalist globalization with a human face?

The arguments given above to explain capitalist globalization as an entrenched neo-liberal and neo-mercantilist transnational process negates the possibility for a truly moral and ethical society to emerge, one that can be governed and directed by any law other than that determined by individual will as the final determiner. Yet there are many who argue that a reformed capitalist globalization with a human face could be possible. Dunning (2004) proposes a top-down approach of institutional guidance, which can be equivalent to the enforcement of the religious beliefs and laws. This would be combined by a bottom-up approach, in which an intensive education and awareness is created at the grassroots levels to understand and adopt the top-down agenda.

Yet at the end of the above explanation, Dunning summarizes the views of other scholars who find that in the face of current ideas on global ethics, pluralism, and secularism a post-modern age will not respond to the religious ethical and moral basis of the proposed transforming scenario. Consequently, one returns back to the methodological individualism of self-interest in the

guidance and law. Therefore, every human concern that touches the grand ecological order, of which we are a part, is uniquely and totally overarched by the totality of the attributes of morality and ethics that the *Tawhidi* unity of knowledge bestows upon the nexus of interrelations.

A systems formalism of unity of divine knowledge

We now formalize the systems model of the *Tawhidi* unity of knowledge in terms of the following symbolically defined terms:

1. Firstly, there is the epistemology of *Tawhid* as the Unitary Law that bestows guidance and instruments of conduct to the grand ecological world-systems. We denote this epistemological premise by the symbol Ω .
2. The carrier of the unitary law into human cognition and application is done by the medium of guidance of the Prophet Muhammad (*Summah*). We denote this premise as the transmitter mapping by S .
3. The first level of human knowledge is thus formed by the realization of a 'bit' of the Divine Law through the medium of the Prophetic Guidance. Symbolically we denote this 'bit' of knowledge formation in the real world-system by the set $\{\theta\}$, which spans all world-systems in an evolutionary way across human potential and nexus of world-systems. $\{\theta\}$ is therefore the result of human comprehension of the world-systems by the mapping of a 'bit' of Ω onto the world-system by the medium of S . We write this transmission mechanism as, $\{\theta\} = S(\Omega)$.
4. The initial causation of $\{\theta\}$ on ontological entities unravels the world-system. That is, if a guidance is available in the form of $\{\theta\}$ from Ω through S then a 'bit' of the world-system is unraveled in terms of the conduct of the law and the organization of life according to this conduct of the Divine Law through the prophetic guidance.
The formation of $\{\theta\}$ is an extensively discursive process that incessantly evolves into higher levels of certainty as the discursive process continues along the realm of investigation by means of the Divine Law.
5. We denote the 'bit' of the spontaneously unraveled knowledge-flow $\{\theta\}$ on the ontological entities by the set $\{x(\{\theta\})\}$, meaning that the emanation of the world-system arises spontaneously from the domain of the episteme of unity of knowledge through the impact of knowledge-flows.
6. A constructed world-system is thus denoted by the spanning of the pair, $(\{\theta\}, x(\{\theta\}))$. This pair marks the ontology of the constructed world-system on the basis of the *Tawhidi* unity of knowledge.
7. The ontology of the constructed world-system on the basis of unity of divine knowledge is thereafter evaluated for testing the degree of human achievement, response and further actionable decisions that must sustain such experiences in unity of knowledge across systems. We thereby move from the reality of the *Tawhidi* epistemology comprising $(\Omega; S)$ to the derived and constructed ontology of $(\{\theta\}, x(\{\theta\}))$. $\{x(\cdot)\}$ is multidimensional along with $\{\theta\}$ as these span diversely complementing nexus of world-systems. In our earlier terminology such spanning world-systems comprise the grand ecological order. Thereafter, the world-systems learn and sustain themselves from the constructed ontology to higher evolutionary realms of the *Tawhidi* unitary worldview. That is, $(\{\theta\}, x(\{\theta\}))$ evolves into higher knowledge-flows, and thereby, into higher levels of the constructed world-systems.

The above circular relations can be written down as follows:

$$(\Omega;S) \rightarrow \{\theta\} \rightarrow (\{\theta\},x(\{\theta\})) \xrightarrow{\text{evolutionary}} \{\theta\} \rightarrow \text{evolutionary} (\{\theta\},x(\{\theta\})) \rightarrow \text{Evaluation} \uparrow \quad (1)$$

In expression (1), the portion,

$$[\{\theta\} \rightarrow (\{\theta\},x(\{\theta\})) \rightarrow \text{Evaluation}] \quad (2)$$

marks a completed process of ontological construction of the world-system as derived from the epistemology of $(\Omega;S)$.

The portion,

$$[\text{evolutionary} \{\theta\} \rightarrow \text{evolutionary} (\{\theta\},x(\{\theta\})) \rightarrow \text{Evaluation}] \quad (3)$$

marks an evolutionary phase of post-evaluated constructed ontologies through and the medium of *Tawhidi* unity of knowledge.

Two central issues need to be pointed out in expression (1). The medium of knowledge formation at any point along the sequences of evolutionary processes concerning the knowledge-induced world-systems is always of a discursive nature. Only the fundamental epistemology remains outside discourse because of its axiomatic nature in the constructed ontology. A discourse along a process is described by interaction leading to consensus (integration) followed by the beginning of a post-evaluated co-evolutionary process involving the tuple $(\{\theta\},x(\{\theta\}))$. Consequently, the *Qur'anic* meaning of the *Shura* as the grand ecological participation to reveal knowledge denoted here by systemically unifying knowledge-flows $\{\theta\}$ is combined intrinsically with the unification experience of the world-systems under the Divine Law. The latter is denoted by $\{x(\{\theta\})\}$. The spanning of all world-systems along the evolutionary experience of interaction and integration in the *Shuratic* processes conveys a meaning of the *Qur'anic Tasbih*. Thus yet other equivalent terminologies for the *Shuratic* process are the *Shura-Tasbih (ST)* experience, and the Interactive, Integrative and Evolutionary process (IIE-process). The evolutionary spanning of $(\{\theta\},x(\{\theta\}))$ in expression (1) defines the constructed ontologies as the learning and evolutionary '*Alameen* (*Qur'anic* world-systems) on the foundation of $(\Omega;S)$.

The second important property of the *Tawhidi* String Relation (TSR) of expression (1) is circular causation that permanently defines the knowledge-induced process methodology. Processes are derived in a recursive manner under the force of the *ST*-experience. Sustainability of the processes in expression (1) is determined by the *ST*-experience, and thus by the circular causation between entities, variables and sub-relations of nexus in the unifying processes.

The third important point to note in the methodology of expression (1) is its nature of openness and closure. The circular causation and continuous learning in the *ST*-experience being pervasive over unifying world-systems the processes remain open. They are only temporarily bounded by evolutionary equilibriums that determine attained epochs of consensus (limiting values) in $(\{\theta\},x(\{\theta\}))$ -values (Grandmont, 1989). But in the very large scale *Tawhidi* universe the completion of knowledge of *all* nexus of world-systems is towards Ω . Thus while the component processes and hence world-systems remain open-ended in the *Tawhidi* universe, the very large

scale *Tawhidi* universe is closed though not bounded, for there is no configuration for Ω ; only relational epistemology is meaningful. The final completion of Ω means the unraveling of the *Qur'anic* Reality of *Lauh Mahfuz*, or *Akhira* (Hereafter) (*Qur'an* 85:21,22).

This explanation determines the *inter*relationship between the closed and open *Tawhidi* universes through co-evolutionary processes as follows:

$$(\Omega;S) \rightarrow \text{Evolutionary 'Alameen} \rightarrow \text{Evolutionary 'Alameen} \dots \rightarrow \text{Hereafter} = \Omega \quad (4)$$

Complex nexus interrelations in the $(\{0\}, x(\{0\}))$ -values and their recursive post-evaluation of simulated objective criterion occur as conceptually and empirically determined ontologies within this IIE-process methodology. The sustainability of *ST*-experience is thereby pervasive in the unifying learning experience along the diverse trajectories of evolutionary equilibriums of such unifying world-systems. See elsewhere (Choudhury, 2000) for a mathematical and empirical formulation of the ensuing issues of expressions (1) and (4).

Addressing globalization issues in the TSR

Systemic embedding by means of knowledge

The central issue of globalization as a networking of market, economic, institutional and cultural issues according to the unity of nations is addressed in the TSR by the unification and complementing principle of pervasive discourse according to the law of unity. The endemic knowledge-centricity in this experience is endogenous in nature. That is such ethical consequences are not driven by coercive policies, rather by guidance out of learning in the IIE-processes. Such a dynamic is similar to that proposed by Dunning in his top-down and bottom-up meeting. However, it takes place in the *ST*-experience by strong causality of circular causation. In such an endogenous framework of guidance, policing and learning to coordinate, organize and evolve there exist increasing returns to scale in the production of social goods (i.e. wellbeing, knowledge, human resource development) with minimizing social and private costs through the medium of sharing of resources, benefits and discourse that open up possibilities for diversity of opportunities. Diverse entities complement each other according to the Divine Law and its implements or contrary entities are phased out and replaced if not acceptable to the law.

The issues of market transformation is subsumed by the ethical priorities of the grand ecological sustainability according to the preservation of life by the guarantee of necessities and the upholding of the Divine Law that protects the moral transformation. The knowledge-induced endogenous way of market transformation has been formalized elsewhere (Choudhury, 1994).

The *Qur'an* presents a grand ecological model of general wellbeing for mankind and the total environment. Within this, social issues of poverty alleviation, distributive justice, common good, empowerment by participation and entitlement by redistribution and productive involvement using cooperative instruments etc. altogether form an embedding of economy, market, polity and social relations. Heiskala (2003) refers to such an embedding as social semiosis, which means the interpretation of social meaning according to an analytical symbolization of circular causation. In the TSR the meaning of reality is rooted in the derivation of rules (*Ahkam*) from the Divine Law and using this to induce consequences in the ontology of the constructed world-systems. Such constructed world-systems symbolize the discursive and unifying ontology. We thus have markets and economy that are built upon the knowledge-flows, consciousness, action, response and continuity of such knowledge-induced ontologies of world-systems.

There is nothing in the *Qur'anic* guidance that is contrary to global ethical bond. Nothing remains unacceptable to human kind in the divinely guided reasoned process. What the *Qur'anic* Law simply turns away from mankind is the arrogance of self, leading to collective hegemony and the evil things (*Fa'sha & Munkir*) as determined by the Divine Law. The *Qur'an* declares, "There is no compulsion in religion. Truth stands out clear from error; whoever rejects evil and believes in *Allah* has grasped the trustworthiest handhold that never breaks. And *Allah* hears and knows all things." (*Qur'an* 2:256).

Factor complementarities in the knowledge-embedded order

According to this principle of inexorable and indelible truth of unity of being in the market order and the economy, we also have co-determination and pervasive complementarities in resource allocation between the otherwise contending and competing entities of the liberal order. The *Qur'an* (36:36) refers to such pervasive complementarities in its imagery of the 'paired' universe. In this sense of pervasive complementarities are determined the empirical representation of linkages and unity of systemic knowledge between noble entities.

The implications of cooperative mechanisms thereby arise between capital and labour; between different segments of a discursive society involved in the *ST*-experience of continuous learning; between different production menus as joint production that are discursively derived and implemented to realize production-diversification, risk-diversification, and sectoral or economic diversification. In turn, the discursively determined economic menus endogenously promote the social and institutional privileges of participation and sharing in costs, risk and benefits. We are thus formalizing a pervasively complementary allocation system between cooperating possibilities that continuously undergo simulation in the IIE-process, as opposed to the pervasive rule of marginal rate of substitution and non-learning of the optimal and steady-state equilibrium universe of mainstream economic reasoning. In the latter case there remain flaws even in the endogenous growth theory (Romer, 1986) and the endogenous family decision model (Becker, 1989) of the neoclassical economic genre.

Complementary financial instruments of the knowledge-embedding order

Next let us turn to the nature of *interrelationship* of the financial instruments with the real economy that heightens the participatory process and thus lubricates the extension of the law of unity of systemic knowledge across the experiential universe. The direct linkage between money, finance and the real economy logically removes the presence of interest rates from the resource allocation mechanism. Consequently, savings understood as holding of capital from the real economy is replaced by resource mobilization into the good things of life.

The *Qur'an* presents a model of embedded development in its ecological framework of total wellbeing explained by the circular causation that pervades between the avoidance of interest, the spending attribute in the good things of life, the charity to all and everything, and the participatory spirit of the paired universe established by the medium of trade in the good things of life. The *Qur'an* gives the basis of such analytical conceptualization involving the moral embedding of economy, society and polity (*Qur'an* 2: 261-83). Such strong circular causality is pervasively sustained in the TSR till the Hereafter. A *Hadith* (saying) of the Prophet Muhammad declares that the doors of search and discovery from the sources of the *Qur'an* and the *Sunnah*, called *Ijtihad*, will prevail until the end of time.

Consequently, money enters the human world, not simply the economic domain, as a great blessing (*Ni'mah*). Money cannot be commodified as in the MCM model of the liberal order, for there is no return on money. The only return to money is from the real economic activities that carry the

blessings of being in the good things of life. In turn the social and economic, polity and global benefits are distributed over the complementing noble things. The *Qur'an* (31:10) declares, "... We send down rain from the sky, and produce on the earth every kind of noble creature, in pairs."

International trade in TSR

International trade in the good things of life comprising flows of merchandise and capital as raised and produced according to the ethical guidance of the Divine Law brings benefits to mankind (*Qur'an* 2:164). In the parlance of the principle of universal complementarities (Choudhury 2003) between the good things of life and the ontological construction of the economy, markets, society and polity as embedded domains carrying the unification of divine knowledge by the instruments of the Divine Law, is now further extended by the medium international trade. Through such systemic extension and strong circular causation interrelationships between the embedded domains with international trade in goods and services, the global model of a grand unified ecology is presented. This marks the knowledge-flows of the TSR that induce and unify the embedded entities, and their circular causation relations establish the unity of knowledge in the *Tawhidi* world-system.

The nature of enlightened self-interest in the Qur'anic sense

The neo-liberal consequence of alienation of capitalist globalization with interest, competition, scarcity and the 'nicety' of optimality and steady-state equilibrium as opposed to the reality of the simulated world-system of complex nexuses of unification of knowledge is now fully replaced. The methodology of the TSR does not allow for marginal rates of substitutions and the resource allocation consequences that these postulates embody (Choudhury 1998). Only the principle of pervasive complementarities defines the resource allocation, institutional participation and social symbiosis between 'noble things in pairs'.

The assumption of self-interest, individual sovereignty and methodological individualism, all coterminous with each other are replaced in the *Qur'anic* context by the principle of reward, mercy and blessing as against punishment in response to the practice of truth as opposed to falsehood, respectively. Thus the cooperating individual aims for and reaps the benefits of a shared social, political, economic and global order only in terms of the expectations of individual rewards, blessing and mercy as against punishment. This is true for both the material rewards and punishment in life and in the Hereafter. Some refer to this kind of human preference as enlightened self-interest (Griffiths 2004). But the precept of unified decision-making transcends lobby-group dynamics associated with the idea of enlightened self-interest. Social coordination is guided by the Divine Law and also in turn is cumulatively driven towards this goal. We name such a strong circular causation structure of decision-making and choice as ethical endogeneity – being a phenomenon of the unifying learning systems. It is inherent in the *ST*- process of the TSR.

Private property rights

Other axiomatic differences between Islam and neo-liberalism are those of private property right and the spontaneous order of market action (Holton 1992). Property rights are not absolute in Islam but are sanctified when admissible property is held according to the legal tenets. Property is treated as a major social artifact that establishes not only claim but also duties to others. The important case of *Zakat* (wealth tax), the annulment of interest in financial dealings, just pricing, avoidance of monopoly and socially abhorring businesses and penalizing the destruction of mutual property rights in the community both locally and globally are used to establish just property rights. Joint venture and joint production and the sharing context of an embedded socio-economic system promote the production of common goods for a market in which decisions are developed through discursive medium of consultation and exchange. Policy matters in such cases of rewards, penalty

and guidance emanate from the participation of polity with community and economy locally and globally in the sense of the IIE-process. This is the nature of endogenous polity and policy determination. Consequently, the imposition of policies on socio-economic matters is always preceded by the *ST*-knowledge induction and responses in the community at large.

Spontaneous order

The meaning of spontaneous order is relegated to spontaneity between knowledge-flows and their induction of the world-system variables in accordance with the *Tawhidi* precept of unity of knowledge using the instruments and institutions of unification. Spontaneous order does not mean the idea of market catalysis advanced by Hayek (1967), whereby a market equilibrium and information flow automatically responds to human designs. In such market processes there is no power in market exchange and visible institutions remain exogenous to market determination. Only invisible institutions or those that replicate the rational behavior in decision-making prevail at large. In the case of the TSR, the presence of pervasive guidance, process of discourse and morally embedded socio-economic and political decisions transform market exchange into powerful social contracts (Choudhury 1996). Market equilibrium and any other socio-scientific process-oriented equilibrium are characterized by evolutionary and unifying character across higher planes of the *ST*-experiences marking the progress of the historical trajectory of TSR.

The economy in TSR

In the end now we can define an economy denoted by 'E' for the case of the TSR by the topological relation given in expression (5) (Choudhury 1999b). See Debreu (1959) for a topological definition of Liberal Economy under perfect competition:

$$E = E(\mathbf{R}, \mathbf{p}, \mathbf{q}, \mathbf{P}, \mathbf{T}; \mathbf{W}) | \theta \quad (5)$$

with $\theta \in (\Omega; S)$ being also recursively determined,

Here **R** (resource), **p** (price), **q** (quantity), **P** (policy instruments), **T** (resource mobilizing instruments and technology), **W** (wellbeing) are each recursively interrelated according to the unifying relational epistemology of $(\Omega; S)$ through the medium of knowledge-flows $\{\theta\}$ so derived and impacting upon these variables and relations. Bold symbols signify vectors. From this broad characterization, specific cases can be derived.

In the case of microeconomics, **W** can stand for the objective criterion of knowledge-*simulated* household social wellbeing function with $(\mathbf{R}, \mathbf{p}, \mathbf{q}, \mathbf{P}, \mathbf{T}; \mathbf{W}) | \theta$ representing the corresponding household-specific variables through the recursive learning experience of the household in its *Tawhidi* experience in unity of knowledge. θ denotes a limiting consensually determined collective and coordinated knowledge-value in decision-making on forms of spending in the good things of life.

In the macroeconomic sense, **W** would signify the knowledge-*simulated* social wellbeing function that is aggregated over complex nexus by the IIE-process extending over households in concert with the embedded economic, society and polity circular causation interrelationships. Once again the $(\mathbf{R}, \mathbf{p}, \mathbf{q}, \mathbf{P}, \mathbf{T}; \mathbf{W}) | \theta$ -relations are taken into account over recursively determined knowledge-flows derived from the *Tawhidi* epistemological foundations. Thus a conscious community in unity of knowledge and the world-systems is established. The *Qur'an* names such a community as the *Ummah*, the conscious world-nation of Islam.

The *Shari'ah* and its dynamics

Our preceding explanation and formalism lead us to the understanding of the *Shari'ah*, Islamic Law in the light of the *Tawhidi* worldview. The TSR identifies two parts with the *Shari'ah*. The part, $[(\Omega;S) \rightarrow \{\theta\}]$ is the epistemological core of the *Shari'ah* and it remains exogenously pre-determined as the immutable axiomatic core. The recursive part of the $\{\theta\}$ -values simulated over the unification experience of the *Qur'anic* world-system is the evolutionary periphery of the *Shari'ah* sustained by the inner core. The *Tawhidi* knowledge-flows and their knowledge-induced entities of the world-systems (*'Alameen*) are ever expanded and strengthened by the increasing comprehension of the *Tawhidi* epistemology. The *Tawhidi* epistemology alone remains perfect, absolute and complete and determines the totality—the Great Message (*Nabaul Azim*) of the *Qur'an*.

Thus in the TSR characterization, the *Shari'ah* is not a human law conditioned in the first place by the vagaries of human rationalism, discourse and interpretation. TSR is not solely based on circumstantial interpretations of *Shari'ah* rules (*Fiqh*). Rather the necessary and sufficient condition for the derivation of *Shari'ah* rules (*Ahkam*) is the primacy and direct reference to the epistemology of *Tawhid* in the *ST*-process of knowledge formation and its ontological construction of the knowledge-induced world-systems.

The dynamics of the *Shari'ah* emanate from the *ST*-experience or the IIE-process interrelationships of circular causation in the TSR. The dynamics of the *Shari'ah* touch pervasively the micro and the complex construction of the micro-macro interface premised on the unification of knowledge. From this fundamental basis *Shari'ah* rules are derived, explained and implemented in concert with the ontologies of constructed world-systems, as explained earlier.

A special case of the money-real economy complementary linkage

In a specific case of deriving *Shari'ah* rules from the TSR we examine again the money and real economy interrelationship according to the methodology of unity of knowledge in the TSR. This is explained by means of Figure 1 (Choudhury & Hoque, 2004a).

In Figure 1, the intersection region between Islamic bank and Islamic insurance (*Takaful*) is the starting point of an ethico-economic process that commences with the determination of $\{\theta, \mathbf{x}(\theta)\}$. These variables were defined earlier. The arrows spanning outwards indicate the enlarging effect of the *ST*-experience with the region AB widening out and carrying along with this the three institution-market interactive and integrative ethical policy, program and organizational variables, namely, EP₁, EP₂, EP₃.

EP₁ denotes the relationship between Central Bank and financial institutions, i.e. Islamic bank as an example, in the 100 per cent reserve requirement monetary system. In other words, the institutional arrangement then is to have the Central Bank hold all the reserve of depositors in the Islamic banks. The commercial bank simply matches its clientele with spending outlets, and thereby, asks the Central Bank to supply a quantity of money, for which the commercial bank pays a service charge to the Central Bank.

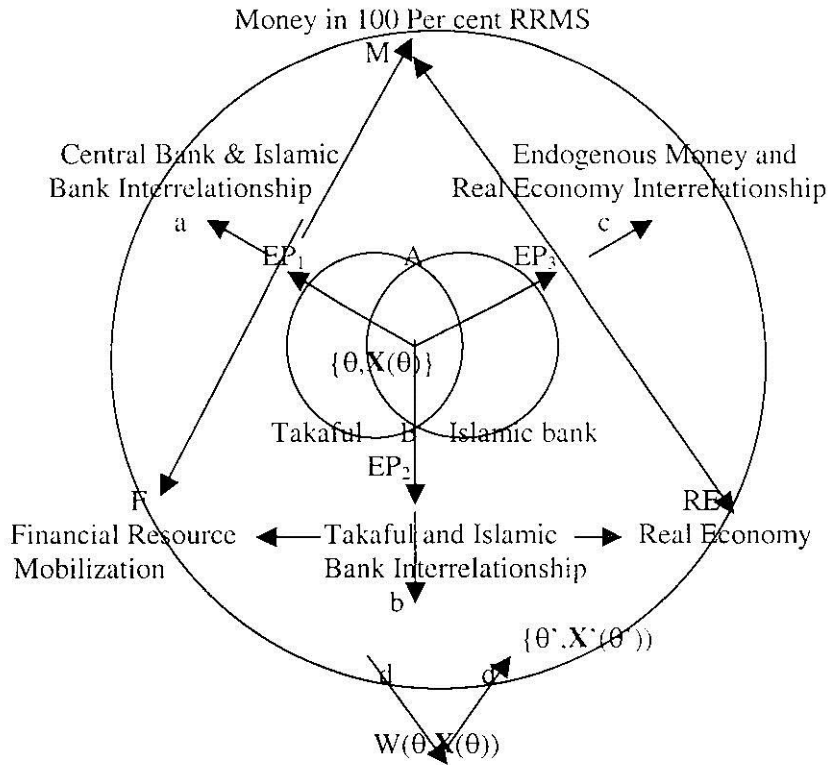


Figure 9.1: Ethico-Economic General Equilibrium Takaful-Economy Interaction in 100 Per cent Reserve Requirement Monetary System

In the case of the 100 per cent Gold Dinar backed currency held by the Central Bank, the minting of the gold by the Central Bank is charged to the commercial bank, which the Islamic bank would raise from service charges to clientele.

Besides this, the risk and product diversification is shared between the Islamic bank and the clientele according to their respective profit-sharing ratios. The Central Bank is primarily an overseer of monetary and economic development and planning authority. The Islamic bank is a clearance house on spending for the Central Bank's reserve liquidity, which is now managed by the Islamic bank on behalf of the clientele. In this venture the commercial bank can assume either proportionate risk with other co-operating agents or full risk by lending the total amount. In the latter case, the sharing ratios are determined by adding to the loaned venture capital the imputed production factor costs by the clientele.

EP₁ also includes the financial instruments, such as the principal ones, *Mudarabah*, *Musharakah*, *Foreign Trade*, *Murabaha*, *Bay Muajjal* and secondary financing instruments revolving around the principal ones.

Above all these, EP₁ also includes the organization of the ST-experience between the Central Bank, the Islamic bank and the clientele.

EP₂ denotes the use of the same kinds of financing instruments and ways of realizing risk and product diversification in order to mobilize financial resources from the Islamic banks through non-

bank financing institutions. An example of non-bank financial institutions is the Islamic insurance. It acts as the medium of risk-diversification and resource mobilization. Above all these, the organization of the *ST*-experience involving Islamic bank, *Takaful* and clientele is foremost in EP_2 .

EP_3 denotes activating of market friendly policies and programs, such as dynamic preference formation in the clientele for attaining regimes of life-sustaining goods, rather than 'wants' and conspicuous spending.

Through EP_3 it is possible to give a valuation to monetary flows in terms of the returns in the real economy realized by effective financial resource mobilization. Such returns being functions of real market transactions are simply net profit rates. The net profit rates can be expressed as a weighted sum of the profit-sharing ratios. This implies that monetary aggregates are micro-monies specific to markets and clientele in the 100 per cent reserve requirement monetary system (Choudhury 2004a).

The further extending arrows 'abc' denote the evolution of the circular causation interrelations between the $\{0, x(\theta)\}$ variables. At the end of every such circular causation there is a post-evaluation of the choices and consequences of $\{0, x(0)\}$ variables in the simulated system. Post-evaluation for attained levels of unity of knowledge in complementing possibilities is done by simulation of the $W(\theta, x(\theta))$ function in any given phase of the complete circular causation. The simulation is realized along *ST*-experience. The circular causation arising from such post-evaluation and its continuity is shown by the arrows dd' .

The double-directional arrows along the sides of the MFRE-triangle imply the endogenous nature of the IIE process of circular causation between M, F and MRE. We now derive the *Shari'ah* rule on phasing out of interest rates. It is not based on an imposed policy of interest-abolition as is usually pre-determined by Islamic banks. Rather, the *Shari'ah* rule for effective interest reduction is based on the unifying experience of money-finance-real economy linkages with institutional guidance and enforcement.

How is the *Shari'ah Ahkam* viewed in the Islamic economics and finance literature?

Predicaments of Muslim scholarship

Asad (1987) correctly puts the predicament of Islamic scholarship as naïve following of spiritual declarations by Muslims (*Fatwa*) and its silence on the *Qur'anic* foundations of the mind. He writes (op cit, p. 54), "This is how it has come about that for centuries past the majority of Muslims have been practicing *taqlid* (literally, "garlanding", i.e. investing with authority): in the words of the classical philologists, this means "a person's following another in what he says or does, firmly believing him to be right therein, without consideration of proof or evidence..... It goes without saying that this practice is an antithesis to a Muslim's duty of thinking and reflecting which is so unambiguously stressed in the *Qur'an*."

Modern *Taqlid* of Muslims is to rely without deep questioning, on the bastion of neo-liberal thinking with only a palliative of Islam on it. This attitude has entered lock stock and barrels the body framework of Islamic economics and finance as a fashion of the present times. Yet the origin of *Qur'anic* thought premised in the *Tawhidi* epistemology has been left in oblivion by the Muslim scholars' unquestioned submission to *Fiqh* and *Fatwa* to derive *Shari'ah* rules (*Ahkam*). *Fiqh* thus becomes the substantive epistemology for understanding the world to the scholarly naiveté. This predicament of Islamic scholarship has disabled the rise of the *Qur'anic* mind for the actualization of the *Ummah* (Ben Nabi 1983).

Muslim subservience to the neo-liberal world-system has predominated thinking in Islamic economics and finance to the extent that the functionality of the *Tawhidi* worldview and its

systemic methodology in unity of knowledge remains incomprehensible to Muslim writers and practitioners today. Even the basic interest-based concepts, such as the time value of money, opportunity cost of resource allocation, utilitarian ideas of wellbeing and material happiness, exogenous treatment of ethics and morals in prevailing models of mainstream economics, and received macroeconomic models and policies have been legitimized. See articles in various issues of *Islamic Economic Studies* and *Review of Islamic Economics*. The end result is that *Tawhid* in Islamic economics and finance exists simply as a mentioned axiom. It does not result in a methodology that would influence in a substantive way the issues, practices and development of the world-system upon which a universal socio-scientific paradigm can be established (Choudhury & Hoque 2003).

How is the question of capitalist globalization treated?

In the global context the challenge of an *Ummatic* globalization (Choudhury, 2002) remains foreign to Muslim thinkers and writers as they increasingly immerse themselves in the mindscape, institutions, businesses and human resource training experiences of capitalist globalization with simply a palliative of Islamic coating and no interior. Most Islamic financial institutions have succumbed themselves to this catching-up fervor in capitalist globalization. It is no wonder how the Muslim World has lost its capacity to uphold the challenges of the *Tawhidi* epistemology in the post-modern age, and instead has increasingly deepened its bondage on all fronts to the whims, caprices and suppression of the West. Thus submission to capitalist globalization by the Muslim World in its present state is not amenable to change, unless the *Tawhidi* epistemology of systemic oneness (i.e. complementarities and linkages by strong circular causation (Maxim 1999, Smith 1992)) is not searched and discovered as the networking of the *Ummah* to establish a universal theory of civilization change. Present capitalist globalization and its emulation by the Muslim World are not premised on this pedestal of hope and renewal (*Tajdid*).

Yet Muslim thinkers like Ahmad (2004) and Chapra (1992) have dealt with the theme of globalization in a palliative of Islamic virtues of justice, fairness and equality that does not bring out the central theme of *Tawhidi* functionality in the global world-system. They take the view that Islamic virtues can be externally applied to the global transformation process through discourse – but discourse with and between whom? -- the vultures of power and greed reigning supreme in the world today? The theme of *Jihad* versus McWorld (Barber 1995) does not arise in their writings. At the end in any outer discourse we are meeting the liberal capitalist giants simply for a social occasion that despite its abhorring of the capitalist enigma with good words of Islamic piety, remains lost in the glamour and maze of deception, confusion and greed.

Muslim writers do not understand the political philosophy underlying the theme of ‘cultural pluralism’ as they plunge into this recently coined term of the Western democratic and neo-liberal genre to mean all is good in diversity and power (Raphael, 1990). The words of Ahmad in regards to cultural pluralism are particularly troubling in the context of a free, superior and independent stand of Islam in the world. Ahmad writes (op cit, p. 191): “It (Islam) spells out a genuinely pluralistic religious and cultural landscape for mankind”. Both the words “pluralistic” and “cultural” are contrary to the *Qur’anic* injunction of *Haqq al-Yaqin* (the true reality) and *Sirat al-Mustaqim* (straight path) (*Qur’an* 10:32) without compromise.

Conclusion

How therefore must Muslims enter a post-modern age of globalization? I have rejected the existing piecemeal approach of the Muslim scholars and institutional developments as a non-starter that has not provided even a challenge in the area of thinking far from its application in the conscious awakening of the *Ummah*. I have called for the continued re-examination of the *Tawhidi* functional

worldview as the core in the reconstruction of the *Shari'ah* in all details of life and thought through the *Shura-Tasbih* process (equivalently the IIE-process), away from both the on-going *Fiqi Taqlid* (Alwani 1991) and Muslim subservience to liberalism. Islam and liberalism are unmixable (Murden 2002).

Towards attaining this end the following broad recommendations are proposed here. But one must note that these are simply suggested as points for further discourse. No detailed analysis is given here. The reader may turn elsewhere for such functional details that bring the *Tawhidi* methodology and worldview to empirical and applied scientific constructs (Choudhury 2003).

1. Harmonize the understanding and application of the *Shari'ah Ahkam* in the *Tawhidi* worldview of systemic unity inculcating the *Shura-Tasbih* process methodology. This will require reform in the educational system by a collective will of Muslim people if not of the Muslim states. Independent forums must be established that would be financed by private funds and must give incentive for jobs and participatory decision-making in the private sector Islamic organizations as a network across the world. A strong network of linkages must be established between these organizations and the economic, social and institutional activities. A private sector secretariat must be established to efficiently run such an organization by private funding.
2. Human resource development along lines of *Tarbiyah* (instilling belief through education) by the *Tawhid* methodology must be inculcated in mainstream school, college and higher educational programs and curriculums with the scientific momentum for understanding, analyzing and applying the *Tawhidi* methodology and worldview to the socio-scientific understanding of reality.
3. Bring about open and specialized forums for the understanding and application of the *Tawhidi* methodology and worldview in both human resource and institutional development. Thus bring about continuous cross-fertilization between Islamic scholars and institutions on the basis of the *Tawhidi* worldview of socio-scientific thought and its applications. In this phase of knowledge dissemination the most modern and sophisticated of methods will be applied in order to galvanize the *Tawhidi* methodology and worldview into quantitative world-systems dynamics.
4. The dynamics of the *Shari'ah* as a continuous advancement for understanding, searching and discovering diverse possibilities in the domain of the *Shura-Tasbih*- experience must be discoursed between all who are consciously involved in the Islamic transformation to the *Ummah*.
5. Islamic transformation in the above form by knowledge consciousness and institutional developments in the private sector ought to think of trade and development across segmented markets of Islamic goods and services. In this way, the evolutionary phases of trade between Islamic units of exchange will increase the supply of dynamic basic needs and raw materials and services between them. Then by sheer market forces this kind of transformation will alter the supply relations of processed and semi-processed materials of the Muslim world with the outside World. As demand remains higher and the supply to the outside World shrinks, the terms of trade of Muslim traders will increase. The higher export revenue so earned can be converted into a developmental fund to enhance the process of *Ummatic* transformation (Choudhury 2004b).
6. Changing the existing monetary and financial system of the Muslim world by privately driven money-real economy complementary and strong circular causation linkages must spearhead the catalysis of the above kind of *Ummatic* transformation.

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7. The momentum of the Islamic transformation building upon the sustainability of the private sector participation in it must take microenterprises as partners along with participants from all rungs of society. Thereby the financial and developmental resources must be mobilized by the full gamut of Islamic development financing instruments.

Many other side-implements of the above recommendations can be made. The above approaches must be taken up simultaneously rather than in piecemeal fashion. The overall focus here is that Islam must be embraced, as the *Qur'an* say, enter Islam with full heart. Thereby, the capitalist globalization agenda will be challenged by the rise of *Ummatic* globalization (Choudhury 2002 op cit). The understanding of such an Islamization process on the foundational basis of the *Tawhidi* worldview must be at the core of the overarching private sector-led cooperative agenda for the realization of the *Ummatic* globalization process. The mistaken idea of pluralism in beliefs to lead to a wholesome world-system is a liberal Utopia and must be avoided. All along, the knowledge and institutions of the *Shura-Tasbih* experience of the *Tawhidi* worldview must centrally fuel such *Ummatic* transformation. Overseeing all such *Ummatic* change must be a guiding institution of the Muslim World with its independent private sector secretariat, well funded and equipped with incentives of material and spiritual benefits in the agents and engines of Islamic change.

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Business Session : 2

19th December 2004, Sunday, 3.00 A.M.~5.00 P.M.

***SOME CONCEPTUAL AND PRACTICAL ASPECTS OF
DEVELOPMENT PLANNING IN THE ISLAMIC FRAMEWORK***

KEYNOTE LECTURE

Mr. Pervez Nasim

Chairman, ISNA Co-op Housing, Toronto, Ontario, Canada.

*Key concepts of Islamic finance and a case study on
Islamic Co-operative Housing Corporation Ltd.*

Mr. Muhammad Iqbal Anjum

The International Institute of Islamic Economics
International Islamic University, Islamabad, Pakistan

*Globalization at crossroads of warfare, revolution,
and universalization*

Dr. M. Shahadat Hossein

Department of Computer Science, CU, Bangladesh.

*The economic development landscape generated by
statistical-spatial domain analysis*

Business Session : 3

19th December 2004, Sunday, 6.00 P.M.~8.00 P.M.

MONEY, FINANCE AND REAL ECONOMY LINKAGES

KEYNOTE LECTURE

Dr. Ahamad Kameel Mydin

Faculty of Economics, IIUM, Gombak, Malaysia.

*The seigniorage of fiat money and the Maqasid al-
Shariah: The unattainableness of the Maqasid*

Business Session : 3
(Continued)

MONEY, FINANCE AND REAL ECONOMY LINKAGES

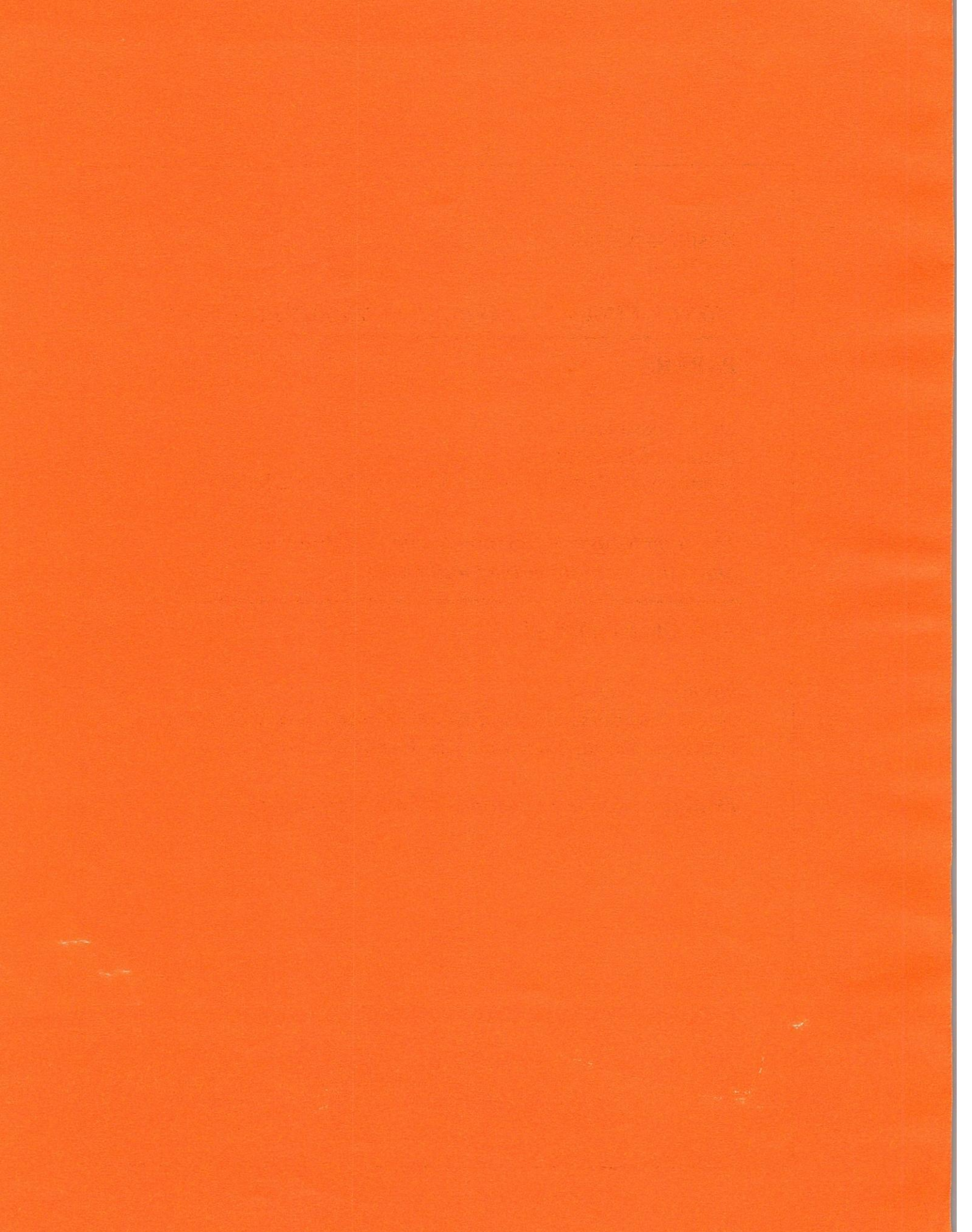
PAPERS

Dr. Moussa Larbani
Faculty of Economics
International Islamic University Malaysia, Gombak, Malaysia.

The seigniorage of fiat money and the Maqasid al-Shariah: viability of the Gold Dinar

Abd. Ghafar b. Ismail
and
Ismail b. Ahmad
Islamic Economics and Finance Research Group School of Economics
Universiti Kebangsaan Malaysia, Bangi, Malaysia

Does the Islamic financial system design matter?



GLOBALIZATION AT CROSSROADS OF WARFARE, REVOLUTION, AND UNIVERSALIZATION: THE ISLAMIC PANACEA, STRATAGEM AND POLICY INSTRUMENTS

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A Retrospective on Globalization

The world has entered the 21st century along with a hope of globalization-based development of all nations, regions and inhabitants of the world. Today, globalization is the most fashionable current economic issue on the whole globe. However, it is the most controversial global issue as well. Today globalization stands out as one of the most universally condemned movement among the global masses. Numerous contemporary violent protests against globalization witnessed at several places in the east and west must be an eye-opener for the champions of globalization. Therefore, globalization deserves a frank debate, pragmatic analysis and a truthful policy response from all humans as well as nations of the globe.

At the outset, it is important to have a clear historical perspective of globalization. It is important to note that globalization is not merely a twenty-first century phenomenon. Of course, the era of true and original globalization commenced with the advent of the first human and the Holy Prophet Adam (Peace Be Upon Him) on the newly created borderless globe without nation states. In this borderless world, a globally mobile community of humans grew over time and practically moved freely along with their goods, services and assets all over the globe in its inherent pursuit of prosperity and development. This desirable ideal pattern of globalization deserves to be called universalization. This original scenario characterized that phase of human history as the golden age of globalization.

In that golden age of globalization, means and ends of the natural movement of globalization were humans themselves in contrast to the limited scope of the contemporary globalization which is concerned only with the free global mobility of goods, services and capital. The advent of Islam reinforced the movement of universalization. The Holy Qur'an upholds the universal right of humans to migrate from one territory to another territory in order to improve their living standard. This fact is clearly implied in the following meaning of the *Qur'anic* verse:

"(Allah has) made earth subservient to you, so traverse ye through its tracts and enjoy of the sustenance which He furnishes."(67,15)

Moreover the aforementioned fact is supported by the practice of the Holy Prophet Muhammad (Peace Be Upon Him) and his companions (Allah Pleased With Them) to persuade people to migrate from lands characterized by scarce means of livelihood to other lands characterized by abundant means of livelihood as a result of which the surplus population of Hijaz initially migrated to the fertile lands of Egypt, Iraq, Syria etc., and then it gradually migrated to Abyssinia, Algeria, Morocco, Spain, Sudan, Tunis etc. Of course, the aforementioned *Qur'anic* verse and the Islamic historical facts imply that Islam recommends the accomplishment of tasks of economic development of all human beings in a universal and global framework and that it rejects the nationalistic geographical barriers which effectively deprive the global citizens of their right of free mobility all over the globe and hence negate their right of economic development.



It was a blessing of this golden age of globalization that West got rid of the legacy of its dark ages by having free access to the wealth of the original scientific and technical contributions made by the Middle East and India.

The golden age of globalization ended with the rise of strong self-interested western nation states between 16th and 19th century in the background of western theory of nation states which has been premised in the western civilization's inherently inhumane, regressive, and anti-globalization strategic agenda of accomplishing disintegration of humanity as well as the globe through the policy of divide and rule. This tragic historical scenario confirms the universal truth that the universally integrative and progressive process of globalization can never coexist with the regressive process of disintegration. This fact is documented by Kalim Siddiqi (1984, 7):

"Another important precaution taken by the western civilization has been the drawing of political frontiers where none existed before. A glance at the political map of the world shows that there are boundaries and frontiers today that, for the most part, are less than a hundred years old. In Africa, 'national' frontiers cut across tribal populations. In some cases, a single tribe has been divided into several 'nations'. Virtually every frontier that exists in the Muslim world today has been created since the First World War. The creation of Muslim states that divide the *Ummah* today is a part of the western civilization's drive towards achieving the disintegration of traditional Muslim societies into small subservient societies. At the same time, the West created identical but competing 'national' leaderships in these areas. Thus a people with a long common history and, like the Arabs, even a common language and culture, were given mutually exclusive and conflicting 'national interests.'"

The violent and selfish pursuit of wealth by the western nation states culminated into slave capitalism, imperialism, colonialism, European as well as global wars, and into the survival of fittest western states. In this background, the western colonial powers developed at the expense of their colonies in Latin America, Asia and Africa by abducting humans and seizing their regions for enslavement as well as by capturing their surpluses through controls on raw materials, markets, international trade and planning. Paul A. Samuelson (1973, pp.788) acknowledged and documented the ugly practical manifestations of slave capitalism as following:

"Little has been told in our history books about the black civilizations and cultures that were flourishing in Africa when the noble Teuton was still cowering over primitive campfires in Northern Europe. We do know how the profit motive led the slave trade: pursuing maximum profit-motive equating marginal revenues and costs, so to speak, merchants used bribery and force to abduct Africans in order to sell them in the New World Hence, the Invisible Hand of competition caused the tidewater regions to specialize in the production and reproduction of slaves, for sale to the fertile lands westward."

Later, the so-called modern globalization was launched by Britain in the 19th century and then it was revived by USA at the end of the cold war. Of course, global peace is a prerequisite for globalization. In a peaceful scenario, globalization proceeds to exploit the gains from international trade through promotion of efficiency and uniformity.

The contemporary movement of globalization has been instituted and led by the western world. This movement views the world as a global village and seeks the economic integration of all the countries existing on the globe in order to ensure their economic convergence and development. Thus, globalization gives rise to a global economic space in which two series of actors meet. One series of actors includes nations, established on certain territories, which tend to regroup in the form of regional organizations. The other series consists of the enterprises which establish the essentials of the regional organizations and favor the transfer of technology as well as the diffusion of knowledge. Convergence means that the poorer countries are required to achieve a faster growth rate of Gross Domestic Product (*GDP*) than the *GDP* growth rate of richer countries.

In this setting, globalization is generally perceived as a universal phenomenon in which social and economic relationships experience immense expansion and reinforcement in a manner that the events of one locality affect other regions of the globe.

It is important to note that the advancements of science as well as technology and the consequent expansion of the market mechanism have been the real forces behind the movement of globalization. Of course, the expansion of globalization has been taking place in all directions. However, the economic dimension has been playing a central role in the process of globalization. In this setting, it is extremely hard to explain the process of globalization merely in realm of science, technology, culture, and environment without taking into account the economics of the market expansion. Therefore, globalization is being increasingly perceived as a worldwide process of increasing integration of the national economies into the expanding international markets. Indeed, the aforementioned mesmerizing agenda of globalization challenges the notion of territorial state, undermines the national borders, and enormously influences the life-style of a nation particularly in case of smaller and more vulnerable countries. So the globalization may be bad from the point of view of cultural diversity. Consequently, smaller countries are facing the twin challenges of digesting the foreign influences as well as effectively pursuing their national priorities within the internationally imposed framework of globalization.

The free trade doctrine of Adam Smith has been advocated by economists who view trade as an engine of growth and development since the time of Adam Smith. The free trade doctrine heralded the global campaign for free international trade as well as the economic integration of different countries. This campaign, which gained ascendancy originally under the headship of Britain during the middle decades of the 19th century and subsequently under the leadership of the United States since 1930s, has recently culminated into a global movement called globalization.

Western Perception of Globalization and Its limited Scope

Globalization was conceived in the writings of the Scottish enlightenment (Khan, 2000, p.21). Historically, according to the conclusion of Bordo and Kornelia (IMF,1997, p.112), the process of globalization observed before 1914 could hardly be termed globalization because large parts of the world did not participate in it and because the then existing low speed of transport and communication was not conducive to organization and operation of markets and firms at the global level.

However, in the context of globalization, the West has perceived global economic space as a place where two series of actors interact with one another. On one hand there are nations, which are established on territories and tend to regroup themselves in the regional organizations and on the other hand there are enterprises which produce and effect most of relationships among territories and favor the transfer of technology and the diffusion of knowledge. Globalization, for the first time, has become like one of the thorough international changes, thanks to the reduction in costs of transportation and communication and to systematic deregulation of markets. Nevertheless, it is not essential that this scenario keeps on in all circumstances. As it happened during 1980s, globalization develops itself in such a way that leads to a major rupture in the performance of the enterprises which assign an essential role to the rate of exchange and which adjust to new conditions of growth.

Flows of international capitals are the most spectacular manifestation of the process of globalization. The financial markets remain open 24 hours out of daily 24 hours. The resulting massive flows of capitals, which have numerous effects on the daily lives in the economies, accompany decrease in the movement of the internationalization of the enterprises.

Long ago, the logic of a firm/company coincided with one of its nation of origin. There was time when the international trade used to represent the mainly the international economic relations. When a production localized in a country A is exported for satisfying the demand in the importing country B and for creation of wealth as well jobs to benefit the country A, the country B can only benefit from one part of the gains from trade. Two types of the international commerce develop. One type of trade resulting from the specialization of the partner countries of the international trade such that each one exports or imports different products. The other type of trade grows between countries characterized by the same level of development such that each one simultaneously exports and imports similar products inside.

Beside the international trade, one has afterwards observed the appearance of foreign direct productive investment as the second form of internationalization. The firm of country A then becomes in creating or taking over (i.e., some more) subsidiaries in countries B, C, D, etc. This productive direct investment, which goes beyond simple creation of commercial subsidiaries, can respond to several types of motivating factors such as impossibility of producing the sufficient quantities in the country of origin, impossibility of selling sufficient quantities of output in the targeted country's market, the possibility of better satisfying the demand in the countries of thriving countries, possibility of producing in the most favorable conditions of certain thriving countries. Multinational firm create jobs in the country which welcomes and often this phenomenon is accompanied at the expense multinational firm's country of origin from which that firm gets increasingly disassociated itself.

The most recent form of the internationalization is the enterprise network. Instead of creating or acquiring strictly controlled subsidiaries within a hierarchical structure, it has to increasingly knit some contractual relationships with the partners emerging in the thriving country especially when it is experiencing industrial take-off. The partnership is gifted by numerous advantages because it permits at the same time to reduce the contribution of capitals and the number of executives/managers leaving the country, manages the national sensitivities/abilities carefully, and better integrates themselves in the local context. More flexible relations, facilitated by the accelerated development of the means of communication, add themselves to the old model of the multinational enterprise and modify, the flows of international trade. This final form of evolution and development, which has begun to shape itself in 1980s has become described by Robert Reich. Of course, the aforementioned myopic perception and practice of globalization points to just a limited practical scope of globalization ranging from internationalization to regionalization. This view is quite contrary to the anticipated universal and humane-centered approach of globalization. It is important to note that the contemporary movement globalization is the flag-bearer of liberalization of international trade in goods and services, and the worldwide application of the rules of World Trade Organization (*WTO*) rules as well as the Basle regulatory standards. However, the agenda of globalization is incomplete and defective because it does not seek the free mobility of labor across all countries and regions of the world. At present, *WTO* is the major vehicle of globalization despite the fact that it is being increasingly condemned everywhere by the poor masses of numerous developing as well as developed countries.

Robert Mundell, has also identified a key link between globalization and foreign investment the benefits of globalization. According to him benefits of globalization depend on the foreign investment and its magic package of capital, technology and markets.

Signs of globalization have been appearing in the form of gradual reductions in quantitative and qualitative barriers against international trade as a result of the ever-growing pressure of capitalist super powers, their allies, and their financial institutions such as the World Bank and the

International Monetary Fund. Consequently, the international goods markets have been expanding along with a dramatic growth in international flows of goods, the number of internationally tradable services has been growing, and capital has been swiftly flowing in diverse ways across numerous countries and regions. This has happened not only due to the continuously declining costs of transportation and communications but also due to declining tariffs and other barriers to trade. In this background, multilateralism-based globalization seems to offer golden opportunities for improving the levels of development and welfare of all the developing as well as developed countries in a long run scenario.

Despite the aforementioned hopefulness associated with the prospective outcomes of the implementation of free trade doctrine, empirical facts imply that the free trade-based process of integration has been affecting the nations unevenly as well as increasing international economic inequalities. This perception is reinforced by Gunnar Myrdal's opinion that the free trade-based expansion of markets often strengthens the developed countries, possessing manufacturing industries which have the lead and which are already fortified by the external economies, as well as weakens the developing countries whose unprotected industries are being outcompeted by cheaper imports from the developed countries.

This point of view has been practically confirmed by the alarming scenarios of stagflation and the deteriorating living standards in developing countries which have been resulting from the implementation of Bretton Woods institutions' policies of mandatory globalization. In this background, in contrast to developed countries' trend of viewing globalization as a vehicle of economic development, the under-developed countries believe that globalization is actually the neocolonialism which has been instituted for ensuring the further economic and strategic empowerment of the western capitalist developed countries at the expense of the under-developed countries on the basis of the theory of "might is right".

Unfortunately, several measures of the flag-bearers of globalization contradict their own announced agenda of multilateralism-based globalization and point to their greater interest in regionalism than in multilateralism-based globalization. For instance, the developed countries' fervent regionalist trends are reflected by their enthusiastic acts of establishing and promoting certain regional blocks¹ such as European Union, Asia Pacific Economic Cooperation, Association of South East Asian Nations, North American Free Trade Agreement (*NAFTA*) etc. This scenario emerges in the background of the western approach of considering regionalism and multilateralism as complementary phenomena. This is why the capitalist developed countries are indeed promoting their own regional blocks in the guise of their so-called campaign of globalization. Consequently, 87% of world trade is concentrated in just three regional blocks- namely the European Union, *NAFTA* and *APEC* (Naqvi, 1999).

In this background, researchers confirmed a gradual increase in GATT²-evading trade restrictions and a departure from free multilateral trade-based globalization during 1980s. Such negative factors led to the ascendancy and rule of regionalism, on the global level, which is self-evident from the existence of over one hundred regional organizations accounting for more than 50% of the global trade. This perception is reinforced by Nawab Haider Naqvi's finding that 87% of global trade is concentrated in only three regional blocks – European Union, North American Free Trade Agreement and Asia Pacific Economic Cooperation (*APEC*).

¹ For example , European Union (*EU*), Asia Pacific Economic Cooperation (*APEC*), Association of South East Asian Nations (*ASEAN*), North American Free Trade Agreement (*NAFTA*) etc.

²GATT refers to the General Agreement on Tariffs and Trade.

The aforementioned arguments highlight the existing conflict between multilateralism-based globalization and regionalism, as well as the following global facts:

- Trends of globalization and regionalization are simultaneously existing on the globe.
- Capitalist champions of globalization are camouflaging their regionalist agenda under their propaganda campaign of globalization.
- The missing commitment of the movement of globalization to ensure the free mobility of all humans across all countries and regions of the world, which is the universal human right, is the prime deficiency of the globalization which makes it to become a human deprivation-oriented global phenomenon. Therefore the contemporary globalization is far away from the ideals of globalization despite all the tall claims of its proponents.

In addition to the already mentioned significant beneficial aspects of the globalization, it is necessary to highlight some additional historical achievements of the modern globalization. It is important to note that in the first phase of modern globalization ranging from mid-1800s to the end of World War I, there occurred dramatic economic convergence in per capita incomes among today's industrial countries due to large international flows of goods and capital along with large international migratory flows.

In the recent phase of modern globalization since mid-1980s, the world trade has increased twice as fast as the world GDP. Now a larger number of countries are participating in globalization.

Clearly some countries have benefited from the success of this engine of this growth. For instance, the US economy has experienced very rapid growth over the past two decades along with the creation 40 million jobs. On the other hand, the recent globalization has not only resulted into lack of cross-country convergence but also caused a sharp decline in the upward mobility of developing countries within the international distribution of average per capita incomes. For example, the number of developing countries in the lowest income quintile has increased from 52 in 1965 to 84 in 1995. Similarly the number of developing countries in middle- income categories fell rapidly from 49 in 1965 to 21 in 1995. In this background, many poor countries like Pakistan have emerged as highly indebted countries.

Total public debt as a % of GDP has dramatically increased from 66.3% in mid 1980 to 100.5% in mid 2000. Pakistan experienced average inflation rate of 14% in 1990s. Government of Pakistan's *Economic Survey 2000-2001* has confirmed that on the average income distribution has worsened in the last three and a half decades and that the caloric-based poverty has increased from 17.3% in 1987-88 to 33.5% in 1999-2000. Moreover, the decline in the already insufficient education expenditures as a percent of GNP from 1% in 1988-89 to 0.5% in 1999-2000 as well as the health expenditures as a percent of GNP from 2.5% in 1996-97 to 2.2% in 1999-2000 point to the missing commitment of the Government of Pakistan to the imperatives of human capital formation and human development

It is important to note that the decade of 1990s proved to be a lost decade for Pakistan on the basis of the empirical findings of the World Bank's Chief Economist Dr. Nicholas Stern. Consequently, Pakistan has entered the 21st century at least as a politico-economic slave of the Western capitalist super powers who want Pakistan to permanently practice the dependant capitalism according to their newly branded grand scheme of globalization. Dr. Nicholas Stern's following observations have painted a gloomy picture of the future of economic growth in Pakistan:

"the probability that current macroeconomic and trade policies will be able to revive growth does not seem high."

Instead of gaining from the process of globalization, Pakistan has lost her economic sovereignty.

The loss of Pakistan's economic sovereignty is mourned in the following response of one of the old pillars of Pakistan's establishment Ex-President Mr. Ghulam Ishaq Khan³ in the context of Pakistan's policy of privatizing the public enterprises:

"Pakistan is not a "free agent"-it has always been greatly affected by what the developed world wants it to do. This is true for all underdeveloped countries and the developed world has not been consistent in what it wants underdeveloped countries to do. In fact, Pakistan has been forced to do what developed countries want it to do. The inconsistency [in terms of economic strategy dictated by the developed countries] has taken the form of: (1) stress on macroeconomics and increasing growth of GNP; then (2) basic needs; and now (3) "free" markets-there is no such thing as a free market. Through out these inconsistent economic policy mandates from the developed countries, no body has even stopped to consider the results of policy. For example, what will be the impact [of privatization] on people in terms of prices, inflation, the environment, [and] employment with the sale of public enterprises? These concerns are not considered -we just must pursue "free" market policies.

Consequently, Pakistan has always been a low income country since the time of its independence despite living in the age of globalization. The lack of convergence in case of Pakistan can be explained in the light of the neoclassical theory. The final result of the neoclassical theory, poor countries would eventually catch up if they could satisfy the following conditions:

- (a) they save as well as invest at the rich countries' saving rate and investment rate
- (b) they ensure that their rate of population growth becomes equal to the rich countries' population growth rate
- (c) they acquire the same technology which is possessed by the rich countries.

Of course, Pakistan can never satisfy the third condition within the prevalent regionalist environment of globalization because of two reasons:

1. A. Q. Khan's paper entitled "Restricted Areas of S&T and Ways to Develop Such Technologies in the Muslim World" highlights the fact that the capitalist developed countries have strictly labeled the Islamic countries as prohibited areas for the transfer of advanced technologies such as computer technology, chemical and biochemical technologies, and the technologies related to software development, aerospace, electronics and defense production.
2. Some clauses of WTO as well as the agreements on Trade-Related Investment Measures tend to slow down the pace of technological advancement in developing countries as well as cause hurdles in the transfer of technology to the developing countries.

In this background, Pakistan can never realize her dreams of convergence and development.

Thus practically, everything is not fine with the globalization. Of course, the historical process of globalizationalization has been accompanied by the good as well as bad outcomes. Unfortunately, the bad outcomes of the process of globalization have culminated into the worst agonies and tragedies for the masses in the east as well as in the west.

The Stratagem, Rules of the Game (So-Called Laws), and Vehicles of Capitalist Globalization

The capitalistic goal of maximizing national wealth has been pursued through a capitalistic politico-economic stratagem of dictating their desired patterns of trade, gains from trade and terms of trade as well as instituting bilateral, regional, multilateral trade wars along with conventional and nuclear wars culminating into a politico-economic and strategic vicious cyclical sequential process of globalization. The cyclical sequential process of globalization involves colonization (i.e., invasion and control of other countries' lands, energy resources, other materials and enslavement of the populations of the invaded countries while at the same time losing hearts of the

³ Baxeter, Craig & Kennedy, Charles, *Pakistan 1997*, Lahore(Pakistan):Pak Book Corporation,1997,pp.82-83.

inhabitants of the invaded lands/countries, and, colonization (colonialism), decolonization (neocolonialism e.g., experience of Pakistan and Palestine whose incumbent President Yasser Arafat has been forced by Israel to live at his base in the West Bank (Palestine) in a situation of house arrest since November 2001), and recolonization (colonialism e.g., experiences of Afghanistan, and Iraq).

The aforementioned stratagem is implemented by enforcing the following rules of the game (i.e., the so-called "laws") of globalization:

- Law of Might is Right culminating into the so-called "Principle of Preemptive Strike"
- Law of Survival of the Fittest
- Law of Perfect Disinformation operationalized through Manipulation of all global means of communication as weapons of mass disinformation.(e.g., American President Bush and his allies successfully disinformed the whole world, for a number of years, by claiming presence of weapons of mass destruction and they used this false claim as a justification for invading Iraq)
- Law of Indiscriminate Exploitation
- Law of Double Standards⁴ and Multiple Standards in International Trade, Finance and Strategic Affairs allowing the promotion of American and European farmers through provision of subsidies and forcing countries like Pakistan to abolish the practice of providing subsidies to their farmers
- Law of Instituting political, economic and strategic Crusades through Global Alliances
- Law of Clash of Civilizations

Of course, World Trade Organization is the prime vehicle of Globalization. Other vehicles of globalization are Multi-National Corporations, UNO, IMF, World Bank, ILO, Asian Development Bank, African Development Bank, capitalist central and commercial banking systems and Global Strategic Alliances of all countries' ruling elite, political parties, military, and civilian bureaucracy which have conditioned by the forces imperialism and colonization and which ensure not only the perpetual division of the human universe into the First World, Second World, and Third World but also the inequitable distribution of politico-economic and strategic power as well as incomes among the aforementioned three types of world and their constituent countries

Agonies of Globalization

Globalization results into the displacement of domestic producers by the low-cost foreign producers. In this background, not only the domestic producers loose profits but also numerous domestic workers such as textile workers and unskilled workers become jobless. In the absence of free international mobility of labor, the unemployment rate assumes alarming levels at which the human lives become so extremely miserable that the glamour of globalization-led lower prices expires in the mindset of the deprived masses and thereby sows the seeds of the degeneration of globalization into an anti-globalization movement. Numerous losers in the process of globalization become the champions and the advocates of movements of "protectionism" and anti globalization" which are the flag-bearer of imposing tariffs and quotas on international trade.

⁴ The United States, a champion of globalization possessing approximately 3,000 nuclear weapons of mass destruction, invaded Iraq on the basis of a false claim that Iraq had weapons of mass destruction and failed to prove the existence of any weapon of mass destruction in Iraq.

Another agony of the globalization-based financial integration is the international transmission of the international financial crises through the globally linked markets. In this age of globalization, any national and international economic crisis emanating from even small disturbances is a direct outcome of the closely linked international markets. For example in the late 1990s, the domestic problems of Mexico, Russia, and Thailand caused chaos in the stock markets and the bond markets of the whole world.

Here it is important to consider the case of American investors who invest their funds in Thailand in the pursuit of high returns. The financial crisis starts when American investors anticipate trouble and pull out their funds from Thailand. This negative development also spills over into financial crisis in other countries who try to support and sustain their exchange rates and financial institutions while confronting a massive speculative onslaught. Such economic crises are ultimately manifest into social and political disruptions and dislocations.

In this historical background, globalization has already raised several fresh challenging issues for policy makers. Now policy makers are professionally bound to empirically determine whether gains from globalizations are worth the domestic costs of globalization. In addition, they must resolve the key question of the economic rationale and scope of preventing the investors from fast pulling out of the invested funds in a manner of threatening the domestic markets.

Globalization at the Cross roads of Warfare and Universalization

Of course, keeping in view the numerous potential benefits of globalization, the persistence of the movement of globalization seems to be better than the absence of globalization. However, the ever-growing confrontation of the global masses with the contemporary movement of globalization is threatening the very future of the western capitalist movement of globalization. This is due to the numerous contradictions between propaganda and practices of the flag-bearers of globalization as well as due to the defective and incomplete agenda of globalization. These factors have stranded globalization at the strategic crossroads of either culminating into a peaceful humane movement of Universalization based on free global mobility of humans or degenerating into an anti-human movement of western regionalism, hegemony, neocolonialism, warfare, and war-lordism.

The road to universalization promises integration, development, security, respect, and prosperity of all humans of the globe. The global mobility of all factors of production in the framework of universalization promises many benefits. The prime benefit will be the maximization of global output by promoting efficiency in the labor-supplying as well as labor-receiving countries. Inflow of labor in the labor-receiving countries can open up the production bottlenecks by reducing inflationary pressures and thereby boosting the aggregate supply. In case of inflow of managers and technical experts, the recipient countries can experience improvements in productivity. Similarly the labor-exporting countries will receive workers remittances. For example, total worker remittances amounted to \$70 billion dollars in 1995. In case of returning workers, the returning workers will bring valuable skills for the benefit of their home country. In short, the universalization will overcome the problem of poverty of opportunities for all humans.

The aforementioned roadmap requires change in the very thinking, personality, and character of the champions of globalization. This inevitably requires them to give up the worship of the twin western idols of self-interested nation states and Euroism or Americanism for ensuring the culmination of globalization into universalization. Of course, the agenda of universalization requires all humans to elevate their statures to such heights where artificial borders drawn under the influence of the western theory of nation states will become invisible and ineffective. Such a constructive universal vision of the champions of globalization will restore a borderless world

originally created by Allah for the common benefit of all humans of the globe. As a result, the contemporary champions of the movement globalization will transform the colonial character of the movement into a universal character. This development will ensure the elimination of the contemporary divisions of the globe which are being manipulated through the western control over the modern science and technology. The unrestricted access to the global public good of technology, according to point of view of neoclassical economists, will allow technology to act as a social and economic equalizer on interpersonal, inter-sectoral, and international levels and will ensure income convergence on international level.

Another prerequisite of globalization is that the champions of globalization, instead of causing political instability in developing countries like Pakistan where governments are caused by them to fall like the fall of wickets in one-day cricket, must practice the policy of non-interference.

Moreover, it must be realized that global peace as a pre-requisite of globalization. Thus global peace must be given all chances for ensuring universalization. The champions of globalization should give up their foreign policy of engineering their puppet regimes in almost all nation states, overthrowing their defiant puppets, committing aggression against the non-capitalist countries, and instituting regular global war patterns which have virtually set the global village on wild fire. The ever-increasing heat of this fire of perpetual global injustice is leading to the awakening of the conscience of the global masses of East as well as West. The whole world is pregnant with an inevitable global revolution, to be launched by the global masses, which is imminent like the uncontrollable dynamics of the Islamic revolution of Iran and which can never be stalled by the contemporary global powers/forces of regression, aggression, injustice and disinformation disguised in the form of so-called globalization. In this background, the decades of dynamics of the Islamic revolution of Iran have great lessons for the global oppressed masses and for the Islamic as well non-Islamic regimes.

The Stratagem, Principles, Vehicles and Policy Instruments of Universalization

Islam, as a universal religion, champions, institutes and promotes the human-centered progressive ideals as well as actual patterns of universalization for the balanced spiritual-cum-material development and empowerment of the personality of all humans existing on the globe irrespective of their ethnic backgrounds, times and places wherein they live. In this context, the following Islamic stratagem of universalization evolves out of the universal Islamic values of comprehensive human enlightenment:

By obligating the pursuit of all sorts of beneficial knowledge, Islam communicates revealed knowledge about the nature of the inherently dignified and respectable status of both the human being and the humanity as vicegerent of Allah (*Subhanu Hu Wa Ta'ala*) and as the best of all creatures, including the ever-developing borderless physical universe, created by Allah (*Subhanu Hu Wa Ta'ala*) and entrusted to all humans for their service, need-fulfillment, development, and politico-economic as well as social empowerment of all humans who are individually integrated with one another, with humanity and with universe through the unifying universal knowledge of *Tawhid* (*Oneness of Allah* (*Subhanu Hu Wa Ta'ala*)). The highly enlightening practicable teachings of the Holy *Qur'an*⁵ and the Holy Prophet Muhammad⁶ (Peace Be Upon Him) transform

⁵ "(Allah has) made earth subservient to you, so traverse ye through its tracts and enjoy of the sustenance which He furnishes."(67,15)

⁶The Holy *Qur'an* (13, 17 declares, " While that which is for the good of mankind remains on the earth". According to the meaning of the Saying of The Holy Prophet Muhammad (PBUH), the better one among humans is that person who provides benefits to humans.

humans into universally mobile as well as mutually beneficial citizens who may be called “*universizens*”. Islam envisages a universally integrated progressive human society consisting of the Islamically educated and enlightened humans functioning as ideal *Universizens*. Islam ensures that all *universizens* have maximum access to beneficial knowledge and perfectly true information through all possible modern Islamic means of communication. The resulting Islamic enlightenment of *universizens*, conditioned by the Islamic principles of justice and benevolence, brings the universal human society into the light which wins hearts of all *universizens*, levels or moderates all *universizens* on the socio-economic and political plane in universal framework, integrates all of them through the Islamic institution of universal brotherhood, makes them more dynamic, powerful, prolific, progressive, and prosperous thereby leads them to the climax of a peaceful universal civilization, modernization, economic development, and eternal success.

The Islamic stratagem of universalization is executed by ensuring the application of the following Islamic principles:

- Principle of enjoining good and forbidding evil
- Principle of ensuring respect of all *universizens*
- Principle of free mobility of all *universizens* in general in the physical universe
- Principle of ensuring socio-economic, political and regional justice as well as benevolence for all *universizens* while establishing the might of right
- Principle of swift dissemination of perfect knowledge and information among all *universizens*
- Principle of responsibility and accountability of all *universizens*
- Principle of free universal trade and investment along Islamic lines
- Principle of making decision on the basis of mutual consultation
- Principle of transparency
- Principle of self-help and universal cooperation for human development, empowerment and security
- Principle of promoting cooperative competition among all *universizens*.

Human as *Universizens* and their institutions of universal caliphate based on the *Ummah*-level *Shuratic* (politico-economic) process are the prime vehicles of Islamic universalization. The set of additional vehicles of Islamic universalization includes the Islamic values, Islamic enlightenment-oriented academic institutions (Mosque, *Madrasah*, *Amr Bil M'arooif Wa Nahi Aa'nil Munkar*, *Salaat*, *Hajj*, Fasting), *Zakaat*, voluntary sector, universal free-trade/market, Islamic central and commercial banks, *Musharakah*, *Mudarabah*, technology, and the Islamic means of mass communication.

The set of policy instruments of Islamic universalization include

- a) progressive humanitarian policies of realizing human development, economic growth, need fulfillment, full employment, equitable distribution of income and wealth, and economic stability
- b) the Islamic enlightenment-oriented policies of ensuring equal access of all *universizens* to the modern facilities of progressive Islamic scientific education and truthful information by establishing all possible facilities means of mass communication
- c) policies of eliminating ethnic nationalism, nation states, and national borders dividing the human universe
- d) policies of equal socio-economic and political opportunities for all *universizens*
- e) policies of eliminating wars and promoting harmony, peace, and integration among all *universizens*
- f) policies of balanced regional economic development

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- g) the policy of optimal *riba*-free monetary management of the single Islamic universal currency by instituting Islamic universal monetary policy regime
 - h) policy of instituting Islamic fiscal federalism designed along the lines of the fiscal model of *Zakat*.

Lessons from Dynamics of Iranian Islamic Revolution

February 1, 1979 signifies a revolutionary threshold in the history of Iran as well as the world as a whole. Before this date, the Western puppet regime of Iranian monarch westernized Iran and made Iran a strategic-base camp for the Western capitalist powers and, thus, instituted as well as accelerated the uncontrollable dynamics of the Islamic revolutionary struggle launched by the oppressed but revolutionized Iranian Muslim masses. The date of the Islamic revolution of Iran merely symbolizes another swift victory of the Islamic spiritual revolutionary forces as a divine reward for the glorious sacrifices of hundreds of thousands of people against the centuries-old materialistic secular Iranian regime which had been effectively backed by the Western powers. In other words, this date reflects the formal recommencement of the contemporary process of eternal Islamic revolution instituted in Iran for revolutionizing the entire global human race.

The crystal-clear universal lessons of the Islamic revolution of Iran for all aggressive materialistic global powers and their allies among the rulers of the contemporary Muslim countries are being highlighted as following:

- a) The Islamic spiritual forces are capable of bringing about Islamic revolutions in all walks of human life.
- b) The Islamic revolutions are always and everywhere possible as an indigenous phenomena and these revolutions can never be reversed by launching disinformation campaigns and by imposing unjustified wars and sanctions.
- c) Especially, economic sanctions have been a blessing in disguise for Islamic Republic of Iran for reinforcing her resolve and economic capacity in order to successfully accelerate economic growth according to the Islamic development priorities and, thus, to sustain and enhance her politico-economic and strategic sovereignty.
- d) In contrast to the most recent natural demise of anti-Islamic revolution regime in Iraq, the healthy persistence of the Islamic regime in Iran signifies the continuing victory of the Islamic revolution in Iran against the anti-Islam western powers and their puppet regimes.
- e) The most recent results of the elections in Iran reconfirm the success and ever-popular nature of the Iranian revolutionary process despite the persisting western sanctions and propaganda war against Iran.

Indeed, there is potential of a peaceful universal revolution in the East as well as West against the overwhelming regressive forces/powers which have been surviving merely on the basis of global disinformation, wars, enslavement, and human disempowerment. Now, the contemporary Islamic revolutionary forces face the challenge of simultaneously realizing the ideals of the Islamic revolution in the form of peace, prosperity, and human development/empowerment in their country, as well as liberating the global masses from the aforementioned regressive powers of the world.

Conclusions

If the globalization has to survive and succeed in ensuring equitable global development, then humans must be the focus of the movement of globalization. Without the provisions for free international mobility of humans globalization is incomplete, inhumane, and immaterial. Otherwise, the voyages of globalization along the roads to nationalism and regionalism will

culminate into neocolonialism, trade wars, world wars, global recessions and the global destruction.

The western civilization has consumed many centuries in discovering the slogan of globalization. In my view, the process of awakening of the human conscience for practically heralding the movement of universalization may take some more centuries.

Global peace can be ensured through a transition from the nationalism-based globalization to universalization which may integrate the entire humanity through universal human values within the original peaceful framework of a border-less globe. Let us strive for the universal peace, prosperity and development of all humans by promoting the universal values and, thereby, realizing universal ideals. Universal human values, which are like universal truths, are indeed capable of benefiting all humans irrespective of their regional background.

The contemporary oppressed and exploited humanity finds itself at threshold of a global revolution and universalization. Iran's Islamic revolution has the potential to provide a ray of hope to global masses for establishing a just, progressive, and humane global order on the basis of the Islamic panacea in the form of a program of human development-oriented universalization.

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**A DEVELOPMENT PLANNING APPLICATION
OF RELATIONAL EPISTEMOLOGY AND *TAWHID***

(A study in Islamic Political Economy and World-System)

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And

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ABSTRACT

A relational epistemology of development planning emanating from the episteme of Oneness of Allah as the worldview of unity of knowledge is conceptualised and made empirically viable by combining statistical quantification and real-time simulation in the spatial dimension. These two estimation approaches and the empirical results are sequentially interconnected; showing how statistical results that are always static in nature can be dynamically represented by real-time graphical simulation in spatial representation. The policy implication underlying the normative issues interconnecting the statistical results and the spatial dimension real-time simulation results by vivid simulation is pointed out. The case study of development planning for the Manufacturing and Petroleum inter-sectoral GDP and total employment relations is considered.***

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A model of relational epistemology and tawhid

Background

Tawhid, meaning the monotheism in the Qur'an, is interpreted in scientific terminology to explain the fullness and supremacy of divine knowledge in a unified worldview of entities that are governed by the postulates of the divine law. In Islam the divine law is composed of two parts, which are inextricably unified. The first part of the divine law comprises the conceptual order of a unified reality that is governed immutably by an order of balance and purpose explaining all things. The other part of the divine law comprises the instruments and guidance that enable the derivation of rules from and application of the divine law to every detail of the socio-scientific order. The first part known as Sunnat Allah in the Qur'an encompasses abstraction, guidance and the unravelling of reality in the scheme of things through contemplative reflection. The second part known as the Shari'ah is the combination of the first part with the practices and sayings of the Prophet Muhammad on the detailed conduct of human affairs by direct implication or extension through investigation in the light of the Qur'an. Such practices and sayings of the Prophet Muhammad known as the Sunnah combine with the Qur'anic law to give the latter explanatory content. The Sunnat Allah is thus realized as a conceptual, explanatory and applicable domain of the divine law into the scheme of all things.

In the realm of mathematical formalism Sunnat Allah invokes the principles that embody the comprehension of a world-system along with its various relational functions that altogether increasingly construct and endow unity of knowledge. The manifestation of unity of knowledge is made possible by the relational epistemology of interacting, integrating and dynamic essence in all entities pertaining to the problems and concepts under consideration. The Sunnat al-Rasul or the Sunnah of the Prophet Muhammad acts as instrumental guidance on the selection and application of specific modes of thinking and choices that together establish the practical rules of implementing specific parts of the Sunnat Allah to conceptual and practical issues of world-systems. Without this kind of substantive instrumental guidance the understanding and application of the divine laws would remain numinous in reality.

Since the foundational essence of Sunnat Allah and Sunnat al-Rasul is the episteme of unity of knowledge and its application to specific problems and issues of a progressively constructive world-system, their impact on the constituent entities and rules of the world-system occurs through increasingly widening domain of inter-entity relationship. The result is pervasive interaction leading to well-determined forms of participatory convergences between them. These phases together lead to the continuity of learning between the entities, thereby causing them evolve in a dynamic universe of pervasive learning. We refer to this permanent feature of learning in the knowledge-induced entities as the coterminous determination of **Interaction, Integration and Evolution (IIE)**.¹ The learning behaviour of the entities in terms of the causation of the knowledge-flows emanating from the combination of Sunnat Allah and Sunnat al-Rasul forms complementary fields of unifying wholes as the IIE processes proceed along the co-evolutionary trajectory of unity of knowledge. Thus every entity in such a widening system of knowledge formation and induction relates in a unified way with every other one. So also the relations and functional transformation between them cause interrelationships of unifying fields to occur and continue in perpetuity. This is the idea of relational epistemology in terms of the continuum of events governed by the episteme of unity of divine knowledge in pervasively learning systems caused by the primal induction and guidance by the episteme of Sunnat Allah and Sunnat al-Rasul. A similar idea but not in the context of unification context of knowledge is provided by Thayer-Bacon (2003).

Objective

The objective of this paper is to formalize a process-oriented model of relational epistemology premised on the unity of knowledge established by Tawhid, comprising the integrated domains of Sunnat Allah and Sunnat al-Rasul. We will then specify this conceptual model of relational epistemology in the framework of Tawhid to the case of development planning. The essential nature of unity of knowledge in the framework of a pervasively learning development system under the process orientation of IIE is exemplified by pervasive complementarities between the entities, their variables and functional relations. The two kinds of inter-relational entities are firstly markets and economy on the one side and polity on the other. The variables governing and representing these entities are the state variables and policy variables, respectively. The functional relations between them are the circular causation interrelationships that explain the IIE processes in view of the attainment of the goal of simulation by learning of the social wellbeing function. The social wellbeing function is the criterion to evaluate the degree to which the IIE-process variables attain a level of complementarities between them as the circular causation proceeds between the variables under the impact of knowledge induction relating to the Tawhidi unity of knowledge as the episteme.

Details

We will formalise the methodological framework of a development reasoning in terms of pervasive complementarities as unifying linkages between critical entities and their variables. The entities are economic sectors, Government, the market and economy. The variables characterising the circular interrelations between them and the entities are Gross Domestic Product by sectors, total employment and implied policy simulation in respect to the normative outlook on inter-sectoral complementarities respecting GDP, total employment and the implied policy variables. Development planning is thus studied as an extensively complementary IIE process involving their desired linkages across sectors.

We develop a model of four integrated mathematical systems. The first one is a conceptual primal model that determines the subsequent model features. We refer to this primal model as the *Tawhidi String Relations* by virtue of the circular causation of unity of knowledge and knowledge-induced forms (entities, variables and relational functions) established in the IIE process. The second sub-model is a statistical empirical characterization of the TSR for the case of inter-sectoral development planning as mentioned above. The third sub-model is an innovative input-output method of distributing the estimated outputs and employment of the statistical sub-model by sectors. The fourth sub-model capitulates on the estimated coefficients and the variables of the third sub-model and applies normative policy simulations to the statistical estimations in order to improve the extent of inter-sectoral complementarities. In this way, the rules and policies on unity of knowledge applied to the system of development planning as inter-sectoral linkages is invoked. The case study of the Sultanate of Oman is used.***

The existing state of reasoning in development planning

The process approach to development planning is distinct from the mainstream understanding of development, which is studied by the neo-classical macro-growth models (Dobell & Burmeister,). The literature on economic development and growth is rich in such mainstream theorizing and applications (Meier, 1995). One of the strongest consequences of such an approach is trade-off between economic and social or cultural variables. A particular example of such a massive trade-off is that of economic efficiency (growth) versus social justice (distributive equity, poverty alleviation, employment creation). Mainstream development theorizing and application treat social and cultural variables as datum (Goodman, 2003). Thus, the dynamic and endogenous effects of

such variables are not methodologically embedded in the development models. In other words, such variables remain non-systemic and are simply used exogenously to the otherwise pure economic treatment of the development models and their analysis. Thus the mainstream methodology of development planning is reductionist in nature.

The tawhidi string relation (tsr): primal process model of tawhidi unity of knowledge

At the outset the focus of attention is on deriving and formalizing a process model of generalized system as explained below:

$$\begin{array}{cccccc} \text{_____} & \text{_____} & \text{_____} & \text{_____} & \text{_____} & \text{_____} \\ \text{1} & \text{2} & \text{3} & \text{4} & \text{5} & \text{6} \\ \Omega \rightarrow_F \{\Phi\} \rightarrow_{F^*} \{\Phi^*\} \rightarrow_{\{0\}} \{0\} \rightarrow_{\{X(\{0\})\}} \{X(\{0\})\} \rightarrow_{\text{New } \{0\}} \text{New } \{0\} \rightarrow \text{continuity} \rightarrow \Omega=H & (1) \\ & & W(\theta, X(0)) & & \text{in repeated processes} & \\ \text{Primal} \rightarrow \text{Derivation} \rightarrow \text{Process of} \rightarrow \text{Post-evaluation} \rightarrow \text{Evolution} \rightarrow \text{Continuity} \rightarrow \text{Closure} \\ \text{stock of} & \text{of primal} & \text{deriving} & & \text{of similar} & \text{in the} \\ \text{knowledge} & \text{knowledge} & \text{knowledge} & & \text{processes} & \text{very large-scale} \\ & \text{- flows} & \text{-flows by} & & & \text{universe} \\ & & \text{discursion} & & & \end{array}$$

The symbols of the Tawhidi String Relation (1) are defined below. The phases of the IIE are shown in (1) below the TSR. Note that the TSR is methodologically identical with the IIE and in another sense also with the decision-making and process methodology of participation called in the Qur'an as the Shura. Furthermore, the abstraction of all kinds of methodological abstractions where systemic participation takes places is called in the Qur'an as Tasbih. We refer to the methodological combination between Shura and Tasbih in TSR as the Tasbih-Shura circular causation interrelations:

Ω denotes the Tawhidi epistemology. That is, Ω explains the fundamental Qur'anic axiom of divine oneness. It can thus be simply understood as the dimensionless but creative and governing origin of all knowledge. Hence we intend to treat Ω as a mathematical topology. Therefore Ω denotes the completeness and absoluteness of divine knowledge. We refer to Ω as the Stock of knowledge of the divine law in the Qur'an, where it is referred to as Lauh Mahfuz. Ω is treated in our work simply as a topological reality, which cannot be nor needs to be configured and quantified. Its function is that of relational mappings by the overarching divine law.

Φ denotes the ontology derived from Ω in the form of the divine law (Sunnat Allah). Φ is thus the knowledge domain of the revealed Qur'an as manifested in the order of the world-systems. It is observed and explained by the completeness and absoluteness of Ω .

F denotes the spontaneous and pervasive unveiling of divine oneness in the cosmic scale through the divine law.

Φ^* denotes the further ontological comprehension of the divine law in Φ as realized through the Sunnah (guidance) of the Prophet Muhammad. This medium of presenting the divine law in living experience is denoted by the mapping f^* .

$\{0\}$ denotes a sequence of knowledge-flows derived from the epistemology of unity by the exercise of Tasbih-Shura discourse at the level of deriving the Usul as-Shari'ah (foundation of the Shari'ah) as the core of the divine law.

H denotes the Event of the Hereafter. This completes the cycle from Tawhid to Tawhid through the process of the knowledge-induced world-system. Thus $H = \Omega$ and $\Omega \rightarrow \text{World-System} = \{\theta \in \Omega; \mathbf{x}(\theta)\} \rightarrow H$. $\mathbf{x}(\theta)$ is a vector of knowledge-induced variables describing unification of a perpetually learning world-system. The World-System is spanned completely by $\{\theta \in \Omega; \mathbf{x}(\theta)\}$.

The medium of the Tasbih-Shura discourse is denoted by the symbol, f1, in respect to stage 1 of the Shuratic or IIE Process shown in TSR (1).

The primordial origin of knowledge is Ω . The process from Ω to $\{\theta\}$ through the Tasbih-Shura medium represents the stage of ontology, that is, the stages of unravelling of the Qur'anic episteme through laws, guidance, rules and events.

The process from Ω to $\{\theta\}$ in the epistemological and ontological meaning of the Qur'anic theory of knowledge is brought out in the Qur'an (4:69):

Formalizing the relational epistemological model of development planning from the tsr

The normative basis of [1] in expression (1) establishes the Qur'anic theory of 'pairs' as pervasive complementarities between entities, their measurable variables and relations in all world-systems. Consequently, the Qur'anic rules as the Sunnat Allah combined with the corresponding guidance of Sunnat Al-Rasul establish various parts of the epistemic rule deriving part [1]. The Qur'anic rule of systemic complementarities as the sign of unity of knowledge establishes the uniqueness of the divine law with the Sunnat al-Rasul to the theory of unity of knowledge in both the abstract and manifest systems and between these two. For this matter we accept this principle of pervasive complementarities as the basis of systemic unity of knowledge in the inter-sectoral case of development linkages.

Part [2] of expression (1) is the Ijtihadi or investigative phase premised on the episteme of [1]. Thereby θ forms a converging knowledge-flow out of a sequence of interacting Tasbih-Shura rounds that lead to consensus or integration in the formation of a temporarily limiting but evolutionary ordinally assigned value of θ and hence $\mathbf{x}(\theta)$. θ being derived from Ω through the explanatory phases of (Φ, Φ^*) carries the same principle of pervasive complementarities into the real-problem domain. Part [2] thus also shows the simultaneous derivation of the unity of causation between both $\{\theta\}$ values converging to θ , and thereby of the knowledge-induced vector of variables $\{\mathbf{x}(\theta)\}$ into a convergent vector $\mathbf{x}(\theta)$. We thereby have the simultaneous tuple $(\theta, \mathbf{x}(\theta))$ in the topological space, since Cartesian spatial description has limited scope in the TSR.

Part [3] of expression (1) is a post-evaluative stage of a social wellbeing function, $W((\theta, \mathbf{x}(\theta)))$ of the complementary tuple $(\theta, \mathbf{x}(\theta))$ according to the episteme of unity of knowledge. In this way a series of interrelations in the interacting, integrating and evolutionary values of $(\theta, \mathbf{x}(\theta))$ are examined to simulate $W((\theta, \mathbf{x}(\theta)))$. This part of the IIE-process is an institutional one where polity-market interactions are evaluated by discourse. The result of such discursive evaluation and determination of limiting values of $(\theta, \mathbf{x}(\theta))$ through the circular causation and evaluation of $W((\theta, \mathbf{x}(\theta)))$ over sequences of the IIE interrelations is the re-generation of new $(\theta, \mathbf{x}(\theta))$ -values. This end-of-one and the beginning-of-a new IIE-process is shown by part [4] of expression (1).

Continuity of the IIE processes with repetitive occurrence of [2]-[4] is shown in part [5] of expression (1). Note that in every such IIE-phases the episteme [1] exogenously determines all the circular causation relations. Thus the circular causation interrelations imply both a learning process emerging out of interaction, integration and creative evolution within a systemic framework of

unity of knowledge caused by the unifying nature of the circular causation. Nonetheless, such a systemic unifying possibility is enabled by the principles, rules and guidance of [1] in every part of the IIE-processes. The rest of the components shown in [2]-[5] form pervasively endogenous regeneration of the IIE-process by IIE-processes taking place between sequences of $\{\theta, x(\theta)\}$ through their various f-relations, as shown.

Part [6] of expression (1) implies that the cumulative learning processes of the TSR get optimised only in the Hereafter and nowhere else within the IIE processes, as the world-system learns in continuum pervasively according to the relational nature of the principle of complementarities. This kind of dynamics marks the relational epistemology of unifying systems. Since the world-systems emerge as they are derived from the fullness of Ω and such world-systems optimise only in H, therefore $H = \Omega$.

The TSR (1) is a simple extraction from a much more complex organization of systems that inter-systemically experience the IIE processes in terms of multi-systems entities, their knowledge-induced variables and multi-dimensional functional relations (Choudhury, 2002a).

This choice of knowledge-flows replacing time dependence of the functionalist and structural compositions of evolutionary learning systems leads into the construction of dynamic models of development planning that are richly institutional in nature and are policy induced. That is because the complex processes of learning by 'pairing' (networking) that emerge are the result of embedded interacting and complementing sub-systems of Tasbih-Shura participation and evolving entities. These interactions lead to complementary preferences and goals formulated and guided by foundational laws. Such laws can be guidance, policies and goals of learning-by-doing in development planning. This kind of normative characterization of the embedded sub-systems negates the existence of dichotomous learning systems that are linearly structured (Holton, 1992).

Formalising an empirical model of inter-sectoral linkages as an example of relational epistemology in industrial development

In applying the methodology of relational epistemology of unity of Tawhidi knowledge to development planning we now formalize a model of knowledge-induced variables and parameters of complementary and linked learning systems in terms of their composite systemic variables (entities).

Consider the phase [1] of expression (1) in terms of deriving rules for development planning. From the Qur'an in terms of the systemic meaning of unity of knowledge as an expression of Tawhid we derive the rule of complementarities by 'pairs in all things'. Thus inter-sectoral complementarities are beacons by the systemic unity presented in the Qur'anic chapters entitled Ar-Rahman (The Beneficent) and Al-Nahl (The Bee) of many others. This Ahkam or rule is further supported by the guidance of the Prophet as the explanatory second part of the relational epistemology of Tawhid. One such Ahadith (saying) of the Prophet Muhammad is the reflection of the example of the markets of bliss in Heaven 'on to' the good markets of the world. The domain of epistemological reference to the formation of a rule (Ahkam) is thus the set (Φ^*).

Next the discourse of the Shura (consultation) referring to the Ahkam Φ^* results in Ijtihad. The derivation of a rule comprehending and applying in terms of Φ^* to the world-system is done through the process of deriving consensual and limiting knowledge-flows (θ) from the fundamental epistemology as denoted by [1] in expression (1). An example is the choice of models, instruments, policies and programs to provide directions and to assign measure to the level of knowledge of

unity gained by interrelationships attained by the specific system that presents a particular scientific problem (Choudhury & Hoque, 2004). In our case this scientific problem requiring analytical attention by the episteme of unity of knowledge is inter-sectoral complementarities generated by means of inter-sectoral complementarities between output flow ($Q = \text{GDPs}$) and employment (E).

Since θ is assigned ordinal values in concert with both the state (market) values and polity interaction, and conversely, for the determination of the market organization under the impact of evolving set of θ -values (Choudhury, 2004a, 2004b), therefore the inter-sectoral vector $\mathbf{x} = (Q, E)$ and θ -values are co-evolved. We write this tuple by $(\theta, \mathbf{x}(\theta))$.

The model of circular causation interrelationships premised on the episteme of unity of knowledge as guided by Tawhid is now constructed. In formulating such a model we first consider a Cobb-Douglas form in sectoral GDP and total employment in which the coefficients appear as partial elasticity coefficients of the inter-sectoral GDPs and total employment in their respective cases. Such coefficients are of the learning type in respect to the normative case of generating inter-sectoral complementarities in the GDP and total employment variables. The Cobb-Douglas production form with dynamic learning coefficients and in the product form of the variables with their respective partial elasticity coefficients implies complementarities between these variables in the dynamic-coefficients type of the Cobb-Douglas model selection.

The selected Cobb-Douglas form is,

$$Q_i = A_i \cdot [\prod_{j,i} Q_j^{\alpha_j}] \cdot [E^{\beta_i}] \quad (2)$$

Which when converted to log-linear form is,

$$\text{Log} Q_i = \log A_i + \sum_j \alpha_j \cdot \log Q_j + \beta_i \cdot \log E \quad (3)$$

Where, Q_i, Q_j denote GDP of i th sector and j th sector;

α_j denote partial elasticity coefficients of Q_i with respect to Q_j . That is, $\partial Q_i / \partial Q_j = \alpha_j$. $\alpha_j > 0$ implies inter-sectoral complementarities in the GDPs and hence sectoral linkages, which conveys systemic idea of learning GDPs in development planning. $\alpha_j < 0$ implies the neoclassical economic type of marginal substitution and hence competition and independence between the Q_i and Q_j variables in the state of optimal output or optimal profit subject to constraints.

E is total employment.

β_i denotes the partial elasticity coefficients of Q_i with respect to E . That is, $\partial Q_i / \partial E = \beta_i$. $\beta_i > 0$ implies complementarities between economic growth (GDP) and distribution (E). Conversely, $\beta_i < 0$ denotes trade-off between economic efficiency and distributive justice. These are substantive issues of development planning.

A_i are the constant coefficients.

$i, j = \text{over all sectors but } i \neq j$.

α_j, β_i will be shown to be dynamic elasticity coefficients under the impact of inter-sectoral linkages conveying systemic learning. The linkages are implied by the positive values of these coefficients. Expression (2) shows that the value of Q_i (hence $\log Q_i$) is negatively related to the values of the partial elasticity coefficients. Hence inter-sectoral growth is reduced by the lack of sectoral complementarities. Inter-sectoral complementarities signify inter-sectoral linkages in ad between GDP values and employment. Transformation of negative partial elasticity coefficients into positive values to bring about better inter-sectoral complementarities in GDP and employment would require knowledge dynamics and enforcement of specific policies. Thereby, the coefficients are dynamically affected by the knowledge-induction under the episteme of systemic (inter-sectoral) unity of knowledge in development planning. But also, since the elasticity coefficients are determined by percentage changes in the inter-sectoral outputs, therefore all the variables are induced by θ -values. That is, as mentioned above the vector variable under consideration is

$(0, Q_i(\theta), E(0))$, $i =$ over sectors. We will return to the formulation of dynamic coefficients later on in this paper.

In our model formulation in this paper we have not explicitly quantified the evaluative social wellbeing function as shown in part [3] of expression (1). Thereby, only the system of circular causation inter-sectoral output and total employment structural regression equations is considered. Consequently, only the parts [1] – [2] of expression (1) in terms of the internal circular causation interrelationships between sectoral output and total employment are empirically studied for the case of development planning in the Sultanate of Oman. For further details on a fuller empirical estimation of the comprehensive system including recursive relations between all of the $(0, x(\theta))$ values in respect to the social wellbeing function one can refer to Shahadat, Al-Hashmi and Choudhury (2004).

Structural Regression System

Expression (3) implies the system of circular causation relations in the log-linear Cobb-Douglas forms in the perspective of learning by unity of knowledge along the IIE processes of expression (1). The sectors selected are Petroleum and Gas, Manufacturing, Construction, Utilities and the Tertiary Services (importantly finance) for the Sultanate of Oman¹. These sectors are to be linked to each other through variables and policies relating to economic output (sectoral GDP) and total employment. Sectoral employment data was not available in the empirical exercise; but would have otherwise provided a more accurate picture on development complementarities or otherwise between economic efficiency and distributive equity in the case of the Sultanate of Oman.

To keep the paper within limits we illustrate our model, its estimation and the underlying policy simulations for generating dynamic elasticity coefficients of learning system with inter-sectoral unity of knowledge (linkages or complementarities) for the case for Manufacturing and Petroleum with the other sectors. For the complete set of estimation and results one can request the research report by Choudhury et al (2004). The following are the estimated structural equations:

Recursively circular causation regression equations: sultanate of oman, 1980-2002

Note:

The SPSS program does all regression estimations. The log-linear form is used to estimate the elasticity of the dependent variables with respect to the independent variables in the circular causation regression system. Thus the estimated coefficients are the respective elasticity estimates of the dependent variable with respect to the corresponding independent variables. *All the coefficient variables are within 95% confidence intervals.*

1) Regression ($Q_s \leftarrow \rightarrow Q_s, E$), (1980 – 1985), (1991-2000):

Legend:

Annual sectoral GDP circularly related with total employment (1980 – 1986), (1991-2000), GDP in millions of Omani Riyals; Employment in thousands.

s= (ma) manufacturing sector, (p) petroleum sector, (g) gas sector, (mi) minerals sector, (u) utility sector, (c) construction sector, (f) sector.

E= Total number of employed labor force

$$\begin{aligned} \text{Log Qma} = & -7.017 + 1.359 \log Qp + \log .306 Qg + .291 \log Qmi - .328 Q_u \\ & (-.970) \quad (1.148) \quad (.607) \quad (2.397) \quad (-.397) \\ & - .171 \text{Log Qc} - .002 \text{Log Qfin} + .401 \text{Log E} \\ & (-.675) \quad (-.101) \quad (.642) \end{aligned}$$

R Square: .99
Durbin-Watson: 2.51

$$\begin{aligned} \text{Log Qpet} = & 5.509 + .104 \log Qma - .175 \log Qg + .0003 \log Qmi + .503 \log Q_u \\ & (6.652) \quad (1.148) \quad (-1.358) \quad (.067) \quad (3.423) \\ & + .008 \text{Log Qc} - .003 \text{Log Qf} - .004 \text{Log E} \\ & (1.291) \quad (-.415) \quad (-.270) \end{aligned}$$

R Square: .99
Durbin-Watson: 1.69

Matrix sub-model

The statistical estimates of the partial elasticity coefficients of the multivariate and multi-equations regression model are fed into a second sub-model. This sub-model is a revised form of a dynamic input-output relationship between sectors. In terms of our relational epistemological categorization of sectoral interrelations, the dynamic form of the input-output model is different from the input-output model that is dynamic only in the time-dependent sense (Oxford University Press, 1989). The Tawhidi knowledge-driven meaning of unified systems dynamics results in the following form of the dynamic input-output model of development planning.

Because sufficient data appropriate for computing the input-output structure were lacking for the Sultanate of Oman, therefore, the input-output coefficients of the model are deduced by applying the partial inter-sectoral (GDP, employment) elasticity coefficients to the net change of the corresponding variable in the contributing sector. This method of deriving dynamic parameters of the second stage sub-model also suggests that the output and investment variables carry in them composite effects of the underlying state and policy variables under the impact of learning to generate socio-economic and institutional transformation out of inter-sectoral systemic unity of knowledge (Lange, 1960, 1966; Choudhury, 2003).

Intersectoral impact matrices generated by applying the elasticity coefficients of the recursively circular causation regression equations: sultanate of oman selected years

Note:

The following matrixes were calculated by using this equation:

$$A_{i,j} = [\% \Delta i / \% \Delta j] * \Delta j; \text{ where } [\% \Delta i / \% \Delta j] = \epsilon_{ij}$$

$i, j =$ over all sectors including itself. In the latter case, $\epsilon_{ii} = 1$. and $A_{i,i} = \Delta_i$

Example:

$A_{M,P} = \epsilon_{P,M} * \Delta M$; means a changes in Manufacturing causing a percentage of the change in Petroleum

The following matrixes are interpreted by the idea of inter-sectoral circular causation effects, which are read off horizontally

GDP (Millions O.R) with GDP x Total Labor (thousands), Oman Selected Years

1980-81	MAN	PET	GAS	MIN	UTI	CON	FIN	E
MAN	11.6	10.7536	0.3744	2.4429	-0.0126	-3.4444	-0.0145	4.2456
PET	15.7644	103.4	-2.782	0.3213	2.478	22.236	-2.3113	-6.612
GAS	3.5496	-18.095	2.6	1.8173	0.9282	7.8153	0.348	-5.7072
MIN	3.3756	0.03102	0.2652	1.7	-0.0147	0.0981	0.34539	0.2088
UTI	-3.8048	52.0102	0.5902	-3.5224	2.1	-21.7237	4.7241	23.664
CON	-1.9836	0.8272	0.4732	0.4097	-0.4074	10.9	1.9024	-9.0132
FIN	-0.0232	-0.3102	0.0052	0.4335	0.2667	5.7443	2.9	-9.0132
THR	4.6516	-0.4136	-0.6526	1.564	0.8442	12.0445	-5.6782	34.8

1991-1992	MAN	PET	GAS	MIN	UTI	CON	FIN	E
MAN	18.6	6.4064	0.6912	0.8622	-0.03	-8.9744	-0.034	8.5156
PET	25.2774	61.6	-5.136	0.1134	5.9	57.936	-5.4196	-13.262
GAS	5.6916	-10.78	4.8	0.6414	2.21	20.3628	0.816	-11.4472
MIN	5.4126	0.01848	0.4896	0.6	-0.035	0.2556	0.80988	0.4188
UTI	-6.1008	30.9848	5.5152	-1.2432	5	-56.6012	11.0772	47.464
CON	-3.1806	0.4928	0.8736	0.1446	-0.97	28.4	4.4608	-18.0782
FIN	-0.0372	-0.1848	0.0096	0.153	0.635	14.9668	6.8	-18.0782
THR	7.4586	-0.2464	-1.2048	0.552	2.01	31.382	-13.3144	69.8

1999-2000	MAN	PET	GAS	MIN	UTI	CON	FIN	E
MAN	92.2	9.0168	2.6496	1.8681	-0.0606	-1.6116	-0.0355	3.477
PET	125.2998	86.7	-19.688	0.2457	11.918	10.404	-5.6587	-5.415
GAS	28.2132	-15.1725	18.4	1.3897	4.4642	3.6567	0.852	-4.674
MIN	26.8302	0.02601	1.8768	1.3	-0.0707	0.0459	0.84561	0.171
UTI	-30.2416	43.6101	21.1416	-2.6936	10.1	-10.1643	11.5659	19.38
CON	-15.7662	0.6936	3.3488	0.3133	-1.9594	5.1	4.6576	-7.3815
FIN	-0.1844	-0.2601	0.0368	0.3315	1.2827	2.6877	7.1	-7.3815
THR	36.9722	-0.3468	-4.6184	1.196	4.0602	5.6355	-13.9018	28.5

The matrix results being computed from the elasticity coefficients and denoting important inter-sectoral linkages (or contrarily), they carry with them important simulation effects caused by policies and selective instruments. These effects ought normatively to convert a development planning that does not recognize complementary linkages conveying unity of systemic knowledge, into one with inter-sectoral complementarities. This part of the exercise is done by computer real-time simulation by converting negative partial elasticity coefficients into positive valued ones. The method of spatial representation of the statistical results is the Geographical Information Software (ARCVIEW) now applied to the domain of development planning. Thus an innovative extension of the use of GIS is accomplished. The results are shown below.

2-d and 3-d diagrams showing real-time computer simulation

The algorithmic procedures used to display the interaction between the manufacturing and other sectors in two-dimensional space are explained below.

Database Fields

The estimated value of partial elasticity coefficient between Manufacturing and other sectors are stored as Value for one of the empirical fields of a table. The same is done with respect to Petroleum and other sectors. The database field table contains three sub-fields, namely, the 'Manufacturing (Man)' and Petroleum (Pet) sectors. The empirical field 'Man' contains the value of partial elasticity coefficients between manufacturing and other sectors. The field 'Pet' contains the value of partial elasticity coefficients between Manufacturing and other sectors. The field called 'Sectors' contains eight sectors. These are Manufacturing (Ma), Petroleum (P), Gas (G), Minerals (Mi), Utility (U), Construction (C), Finance (Fin) and Employment (E). In this way, eight records are created. Each record contains a value of each of the fields of the table. The database was saved as a file in the data repository (Table 1).

Sectors	Man	Pet
Manufacturing	1.0000	0.1040
Petroleum	1.3590	1.0000
Gas	0.3060	-0.1750
Mineral	0.2910	0.0003
Utility	-0.3280	0.5030
Construction	-0.1710	0.0080
Finance	-2.0000	-0.0030

Statistical data

Table 1: Database Table

Spatial Data Structure

A spatial analysis is used to integrate the statistical estimations in their tabular form with spatial representation of the same in graphical form. Taking this database conversion into account, graphical data can be thought of as geometric point objects generated and the information on their shape, location and attributes stored in three separate files and an explicit relationship (one-to-one) is maintained between them. In this way, a structure to store information about a point is considered. The structure represents a spatial data format, since it considers geometric, locational and attribute information of a graphical object. We call this spatial data format as a Shape File. Shape file is a combination of three files mentioned above. The display of the shape file is shown in Figure 1.

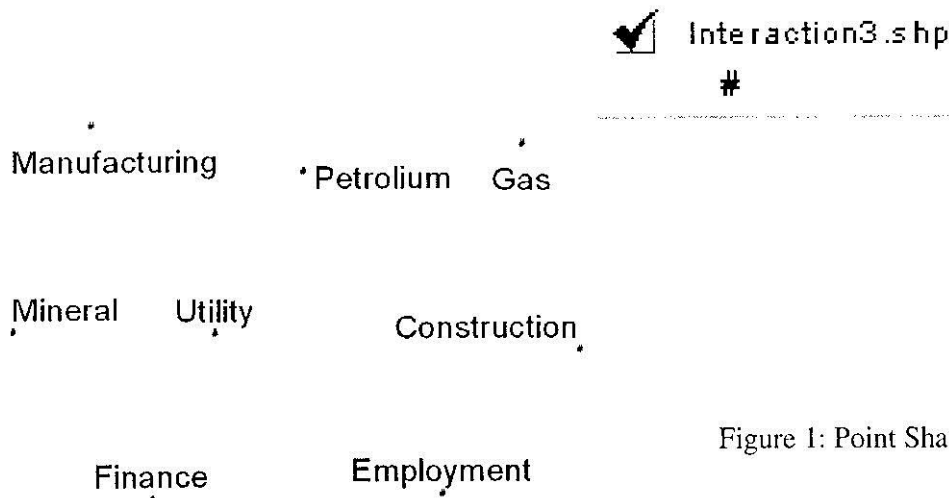


Figure 1: Point Shape File



In Figure 1, each sector is represented as a geometric point object. This facilitates a one-to-one correspondence between the records of the database and shape files. The operation of integration between tabular data and graphic data requires a common field in both of the database. A field named 'Sectors' was created in the table associated with the point attributes of the shape file. This allows for the integration of statistical tabular data with graphical data, since both of the databases contain a common field named 'Sectors'. Finally, using this commonality the data from the database file is appended in the 'attribute file' of the graphical shape. In this way, the integration of tabular and graphical data is achieved. The resulting results representing simulation of the statistical results in spatial graphical space are shown in Figures 2-4. See further the Technical Appendix.

2-D Surface Generation



Figure 2 (a): Interaction between Manufacturing and other

Sectors

Figure 2a illustrates the interaction between Manufacturing and the other sectors. The intensity of interaction is highest in the deeply coloured region and reduces with the thinness of colour. It is important to mention that statistical data has been assigned as a value to one of the fields ('Man') of the database file and this file were appended with one of the files of the spatial vector data structure known as shape file. In this way, statistical data were converted into spatial domain. Figure 2 demonstrates this conversion in a graphical way. Such a transformation from statistical space to spatial domain enables a better visualisation of the interaction between the sectors, which is not possible in statistical approach.

The most important result here is the possibility of visually simulating the statistical results in real-time. Each of such moving simulated point in the spatial domain represents a policy-induced form and the use of appropriate instruments that cause better linkages between the sectors. The improving linkages move the lighter regions into deeper regions, which means that there is enhancing intersection between the regions that in the first instance of the estimated results are found to remain independent of each other. That is the partial elasticity coefficients are negative, while they are simulated in the spatial domain into positive valued ones.

3-D Surface Generation

A more realistic visual display of sectoral complementarities (linkages) conveying systemic unity of knowledge can be done in the 3-dimension representation. Figure 3 shows in this case the prevailing state of linkages (or not) between sectors.

As shown in Figure 3, a network of complex sectoral interrelationships can be shown. On the other hand, 2-D allows the linear interrelationship to be displayed [Figure 4], which is not enough to demonstrate the presence or absence of linkages or trade-offs between the sectoral output and

employment (likewise capital expenditure). Figure 4 simply approximates the log-linear form that we have estimated in the statistical space.

In Figure 3 elevation means the sectoral complementarities as signs of linkages and diversification while trough means sectoral trade-off as sign of absence in linkage and diversification. In this way, various points of elevation and trough visualise the nature of the topography, which can be termed as development landscape originated through a series of spatial analysis starting from shape file.

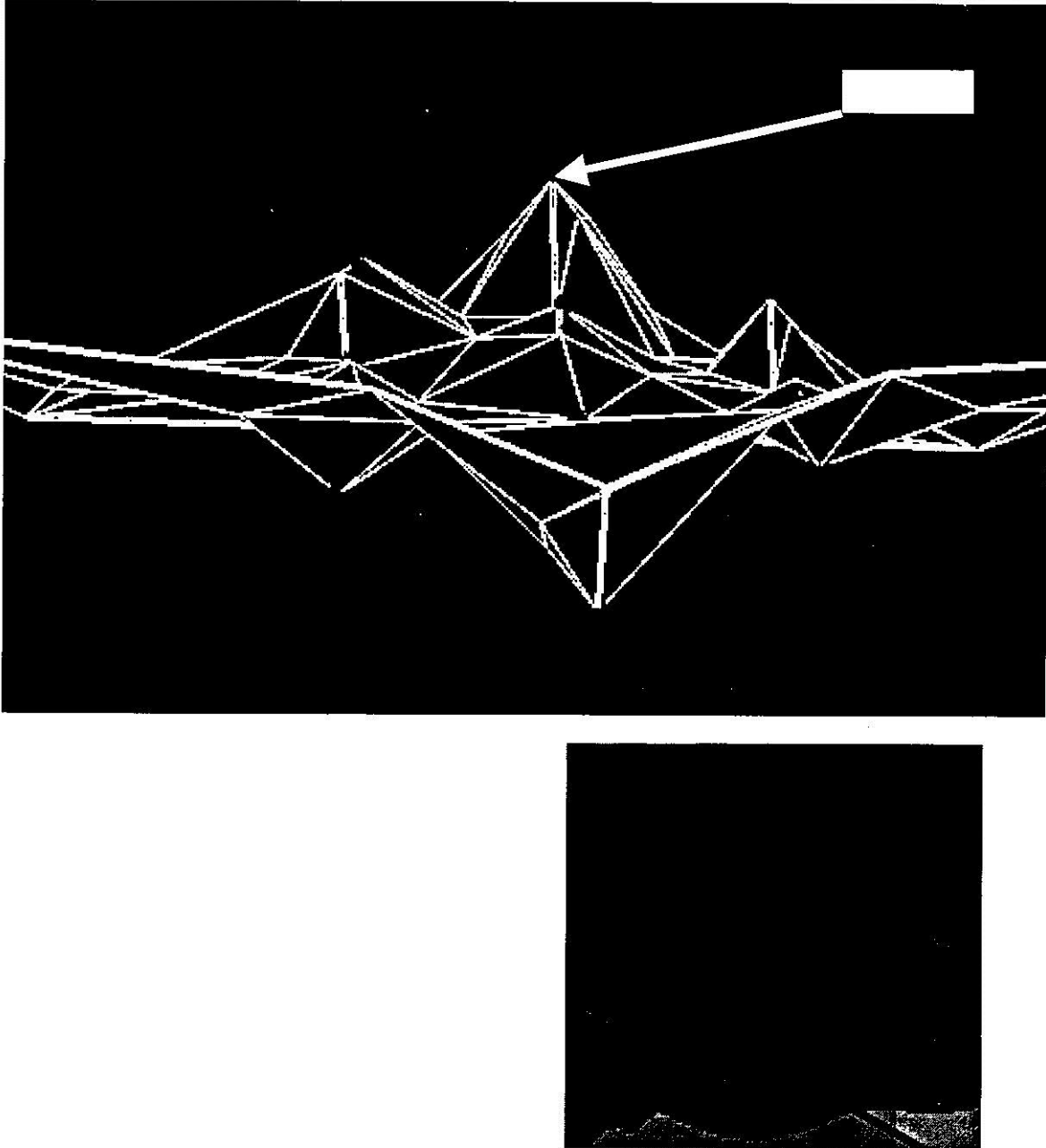


Figure 4: Linear Sectoral Relationship Displayed in 2-D space

Policy impact in converting negative partial elasticity coefficients into positive values by real-time visual computer simulation

It can be shown by actual real-time simulation using Figure 4 that this figure contains a pervasive field of different values of the partial elasticity coefficients in respect to different sectoral interrelationships in Gross Domestic Product and total employment. Only two of these possibilities, namely those shown by the lines in Figure 4, and which are approximated by our statistically estimated log-linear forms for Manufacturing and Petroleum inter-sectoral relationships in GDP and total employment, were analysed in the estimated regression results. But normative policy perspectives in the light of pervasive complementarities and linkages between sectoral GDP and total employment need the negative partial elasticity coefficients to be converted into positive values. This is realized in Figure 4 by real-time simulation of a given negative partial elasticity coefficient into a positive form. This means that the lighter regions are made deeper by bringing their graphs into intersection with the deeper regions.

Movements of the partial elasticity coefficients of this kind represent important policy issues. The conversion of such negative values into positive ones implies sectoral linkages and complementarities in GDP and total employment. Hence improved human resource development, appropriate choice of technological change in concert with human resource development and employment development together with distributive policies of job-creation and sustainability of the sectoral linkages are some of the policy areas that are implied by the value transformation.

Conclusion

We end up this paper by pointing out that the relational epistemology model of pervasive complementarities in the framework of the Tawhidi unity of knowledge worldview, which is applied here to study linkages between industrial sectors is a powerful positive and normative model of development planning. While the Tawhidi episteme is a deeply philosophical conception involving economic and social issues in development perspective, it is also a pragmatic and rigorously empirical one with extensive normative policy implications. We have brought out these perspectives of the Tawhidi relational epistemology model by means of empirical quantification in both the statistical and spatial dimensions of real-time simulation. The results are impressive for guiding policy in cases where there are negative partial elasticity coefficients between sectoral GDP and total employment. The same model can be extended in much broader contexts of development planning in inter-sectoral, national, regional and global perspectives.

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THE SEIGNIORAGE OF FIAT MONEY AND THE MAQASID AL-SHARI'AH: THE UNATTAINABLENESS OF THE MAQASID

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Abstract

This theoretical paper reasons with simple deductions, that the *maqasid al-Shari'ah* are impossible to be attained in an interest-based fiat monetary system. The issue at hand is the seigniorage of fiat money and the question of **what constitutes money**. Using the quantity theory of money and the socio-economic implications of the current monetary system, the paper argues that, indeed, on the contrary, the interest-based fiat monetary system works opposite to the *maqasid*. This strong yet important contention has serious implications, which even means that the process of Islamization of knowledge/disciplines is futile without addressing this issue first. Accordingly, the establishment of Islamic economics, banking and finance, therefore, warrants a serious look into the current definition of money and monetary systems. The paper argues in favor of commodity monies like gold and silver as *Shari'ah* compliant money, and being compatible with the *maqasid*.

Introduction and Objectives of Paper

The 1970's saw the beginning of Islamic resurgence with works on Islamic economics, banking and finance mushrooming. Yet till today, these merely exist only in writings and academic works. In the real world, a truly working model of an Islamic economic system is yet to be seen. Islamic banking first seemed the best practical aspect of Islamic economics, but nonetheless, evidences show even that is now converging back to its conventional counterpart⁷. Contrary to its glorious times, the present Muslim world is characterized by economic backwardness, with increasing disparity in income distribution, poverty etc.

The history of money in Islam started with the use of the Roman Byzantine gold coins, i.e. *denarius* or known as the *dinar* among the Arabs and the Persian silver coins, i.e. *drachma* or known as the *dirham*. The Arabs did not mint their own coin during the times the Holy Prophet Muhammad (peace be upon him) preached the message of Islam. The Prophet (peace be upon him) brought about sweeping social transformations and changes that included business matters, but nonetheless, the Prophet (peace be upon him) accepted the Roman *denarius* and the Persian *drachma* as the monetary units for Muslims, i.e. as the *Shari'ah* money⁸. Prominent Muslim

⁷ See Meera and Larbani (2004).

⁸ Indeed, the words *dinar* and *dirham* are found in the Holy Qur'an in the verses Ali-'Imran (3):75 and Yusuf (12):20 respectively.

scholars of the past, like al-Ghazzali, Ibn Taymiyyah, Qudama Ibn Jaafar, Ibn Khaldun and al-Maqrizi have asserted that Allah SWT had created the two metals, gold and silver, as a medium of exchange and a measure for all things⁹. Gold played the role of money throughout the Muslim history albeit some ‘hiccups’ with the copper *fulus*¹⁰ and with fiat money towards the end era of the Ottoman caliphate. Nonetheless, gold continued to be part of the international monetary system in one way or another until the breakdown of Bretton Woods in 1971. Today all national currencies are fiat¹¹, whereby it is neither backed by nor redeemable for gold, i.e. without any intrinsic value.

Thirty years of global fiat monetary system has now brought the world to a unique position. Many countries have faced monetary crises concurrently in this short period and even a dollar crisis seems imminent¹². It has been highly inflationary, with ever widening disparity in the distribution of income and wealth; and has witnessed numerous global economic crises and social misery. This paper argues why fiat money is importantly at the root of all those problems. It also argues why the creation of fiat money is truly a profound and devastating *riba*, and importantly why it is impossible to achieve the objectives or *maqasid al-Shari’ah* in an interest-based fiat monetary system. Part II of this paper contends that the use of real monies like the gold dinar and silver dirham and the elimination of *riba* are necessary conditions for the establishment of an Islamic economics and financial system, which otherwise would merely remain in the academic circle and discussions.

The global monetary system, undoubtedly, has gone through tremendous evolution - from the use of primitive monies like cowry shells, salt and leather, to precious metals like gold and silver, to fiat money like paper currencies and electronic money. After Bretton Woods, the world has been under a floating exchange rate system with none of the international currencies being backed by gold. History has shown that the kind and the characteristics of money define the nature and characteristics of relationships that exist in the economy that affect socio-economic factors¹³. Today, peoples’ life has been reduced to a life of materialism, characterized by constant pursuit of wealth, competition, lack of compassion, poverty, falling traditional values, crime, less time for family and leisure etc.

Needless to say, *riba* is strongly condemned in Islam; and *riba* has a lot to do with the monetary system. Why Islam places so much emphasis on abstinence from *riba*?¹⁴ This paper intends to show the devastating effects of *riba* on socio-economic factors. Importantly, it argues why the creation of fiat money itself, to be precise, its seigniorage, is profound *riba*¹⁵, that indeed negates the attainment of *maqasid al-Shari’ah*, which in turn prevents the real-life implementation of *Shari’ah*, including the establishment of Islamic economics, banking and finance.

Muslim scholars have defined *riba* well and hence we do not intend to repeat it here. Nonetheless, the nature of *riba* – its new shapes and dimensions in current times - is pertinent to our discussion. One feature of *riba* is where extra purchasing power is created without taking on any risk. So

⁹ See Sanusi (2002).

¹⁰ See Mohamed (1998), p61.

¹¹ A fiat money is money that has no intrinsic value of its own, e.g. paper money and electronic money. The worth of paper in paper money, for example, is negligible yet it may command value by the decree of the issuing body that makes it a ‘legal tender’, i.e. it is money by virtue of law and not because people value it for its own sake.

¹² See Lietaer (2001), p.15.

¹³ Ibid, p.4.

¹⁴ The Prophet’s (s.a.w) condemnation of *riba* in his last sermon at Mount Arafat and the fact that the last verse to be revealed in the Qur’an is about *riba* (from Ibn Abbas as stated in Sahih Buhari) signify the grave importance of the *riba* issue.

¹⁵ A fact that is often neglected, unnoticed or even not understood.

when A lends out, say \$1,000 to B at 10 percent interest per annum, for example, the extra \$100 that B has to pay as interest provides additional purchasing power¹⁶ to A, obtained without assuming any risk¹⁷. This additional 'free' purchasing power is *riba*. Note that in this case the *riba* is materialized only after one year when B pays back \$1,100 to A. Nevertheless, a fact that often goes unnoticed is the fact that creation of fiat money indeed enthrones the creator with **immediate** purchasing power without assuming any risk! Today most money is nothing but electronic records that provide millions and billions of purchasing power to the first users of this electronic money¹⁸. Wouldn't this then constitute a greater *riba*?

With this in background, the next section discusses the *maqasid al-Shari'ah* and the socio-economic effects of fiat money, and thereafter reasons why it is impossible to attain the *maqasid al-Shari'ah* in a fiat monetary environment.

The *Maqasid al-Shari'ah*

Al-Ghazzali states that the very objective of *Shari'ah* is to promote the welfare of the people, which encompasses the safeguarding of faith, life, intellect, posterity and wealth. Anything that protects or promotes these is considered as serving the *maslahah* and hence desirable¹⁹. Similarly, Ibn al-Qayyim al-Jawziyyah states that the basis of the *Shari'ah* is wisdom and welfare of the people in this world and the hereafter; and welfare is said to lie in justice, mercy, well-being and wisdom²⁰. Abu Ishaq al-Shatibi too contends that the *Shari'ah* aims at the welfare of the people in this life and in the life hereafter by protecting its objectives or *maqasid*, which can be classified as follows²¹: 1. *Daruriyyah* (Necessities), 2. *Hajiyyah* (Requirements) and 3. *Tahsiniyyah* (Beautification).

Daruriyyah are objectives which are must and basic for the establishment of people's welfare in this world and the hereafter; the ignoring of which can cause *fasad* to prevail. *Daruriyyah* basically relates to the protection of the following five crucial matters as stated by al-Ghazzali: 1. Faith (*Deen*), 2. Life (*Nafs*), 3. Posterity (*Nasl*), 4. Property (*Mal*) and 5. Reason (*'Aql*). These are necessary or *daruriyyah* for the establishment of welfare in this world, as well as in the hereafter. In other words, these are *daruriyyah* for the establishment of Islam itself on earth. The renowned Muslim economist, M. Umer Chapra states²²:

The *maqasid al-Shari'ah* is everything that is needed to realize *falah* and *hayat tayyibah*; and faith is the most important ingredient for human well-being. It puts human relations on a proper foundation, enabling human beings to interact with each other in a balanced and mutually caring manner to help ensure the well-being of all. It also provides a moral filter for allocation and distribution of resources in accordance with the dictates of brotherhood and socio-economic justice, and a motivating system that brings biting power to the goals of need-fulfillment and equitable distribution of income and wealth. Without injecting the dimension of faith into all human decisions,it may not be possible to realize efficiency and equity in the allocation and

¹⁶ Positive real interest rate is assumed.

¹⁷ Because interest is demanded by decree of the loan contract, irrespective of whether the borrower makes profit or not.

¹⁸ Counterfeiting is illegal particularly due to this free purchasing power from the first use of the money. Subsequent circulation of the money would not provide any more benefit to the counterfeiter.

¹⁹ See Chapra (1992), p.1.

²⁰ Ibid.

²¹ See Khan and Ghifari (1992).

²² Chapra (1992), p.7.

distribution of resources, to minimize macroeconomic imbalances and economic instability, or to overcome crime, strife, tensions and the different symptoms of anomie.

Hajiyah are *Shari'ah* provisions that remove hardship and thereby facilitate life while *tahsiniyyah* are provisions that bring comfort and beauty to life. Unlike these two, *daruriyyah* is essential; and Shatibi puts it that *daruriyyah* is fundamental to *hajiyah* and *tahsiniyyah*. Deficiency in *daruriyyah* brings deficiency to *hajiyah* and *tahsiniyyah*, but not vice versa²³.

The next section discusses the socio-economic effects of the seigniorage of fiat money, and how it negates the attainment of the *daruriyyah* category of the *maqasid al-Shari'ah*.

Seigniorage of Fiat Money and the Continuous Growth of Money Supply and Debt

Seigniorage²⁴ is the gain to the one who issues fiat money. It's the benefit one derives from the first use of fiat money. In today's interest-based fiat money system, the bankers create money through multiple credit creation and lend this out at interest. Money created through this fractional reserve banking system and the interest charges thereupon are basically also seigniorage. Most governments get the benefit of seigniorage from the issuance of their respective national currencies (paper notes and coins) but the seigniorage of credit money and interest charges go to the bank.

In this regard, three main features of the current monetary system, that have been much criticized by Muslim scholars, and pertinent to our discussion are: 1. Fiat money includes paper money and bank money (demand deposits including electronic money). 2. Interest. 3. Fractional reserve banking. These three features are fundamental to the process of money creation by the banking sector²⁵. The banking sector gives birth to most money, by means of the fractional reserve system, i.e. through multiple credit creation. The bank creates money for the first time when it extends loans. Hence money in most part takes the form of accounting entries or computer electronic records. This simple accounting entry that carries with it purchasing power created out of nothing is the seigniorage of fiat money. An important fact to note is that all this new money is introduced into the economy predominantly as loans²⁶. It is important to note here that the Islamic banks, operating within the fractional reserve banking system, also do create money in this form, but focuses on the use of this newly created money according to *Shari'ah* principles.

In addition to fiat money created through the fractional reserve system, interest rates given and charged by banks also increase money supply, all through mere accounting²⁷. In time, therefore, the banking system would be forced to continually increase fiat money so that the reserve requirement can be met and, thereby, sustain the system²⁸. The implication of this is that the existence of interest rates would themselves, *ceteris paribus*, force a continuous increase in money supply, both state money (currency notes) and bank money (loans).

²³ Khan and Ghifari (1992).

²⁴ Seigniorage is the value given to fiat money (that practically costs nothing to produce and has negligible intrinsic value).

²⁵ A process that is least understood by the masses, including even many who are trained in economics, banking and finance. For the interested reader Meera (2002a) illustrates the money creation process.

²⁶ The formula for multiple credit creation can be written as follows:

$$D = \frac{1}{r} \times R$$

Where D = change in total checkable deposits; r = required reserve ratio; R = change in reserves. Hence if the reserve requirement is 4 per cent, as is in Malaysia currently, an initial deposit of RM1,000,000 can bring about a total deposit of RM25,000,000, i.e. an additional RM24,000,000 being created in the form of loans.

²⁷ See Meera (2002a).

²⁸ Historically, in most countries the public and private sector debts have continuously grown to sustain the system.

On top of that, the credit card system also increases the money supply. This is because in every credit card transaction one account gets debited while another credited. The credit entry is, nevertheless, interpreted as a deposit and, thus, that makes possible further money creation through the fractional reserve system. Furthermore, if a cardholder fails to settle his or her credit card balance, then an interest charge on the balance and a late payment fee are likely to be imposed!²⁹

Since most money is created through multiple credit creation, money and debt are, therefore, balance sheet counterparts. This debt would show up in the aggregate economy in the form of private sector and public sector debt. In most countries, bank money (loans) is the dominant money supply that comprises of simply accounting entries. A much smaller portion is paper money and coins issued by the government. Table 1 provides the monetary aggregate statistics for sixty-two countries. On average, state money (hard currency and coins) is only about 34 per cent of the broad money, M2. Sixty-six percent is money predominantly being created by banks as loans. The average annual growth rate of M1 (narrow money) and M2 (broad money) is a staggering 36.92 percent and 41.40 percent respectively. Credit money, nevertheless, has a number of serious economic implications. An important implication is that loans are **non-repayable in aggregate** and that makes loan defaults as a system default in the current monetary structure. A mathematical derivation of why loans are non-repayable in aggregate, i.e. why default on loan is a sure thing to take place follows in the next section.

Table 1
Country Monetary Aggregate Proportions and Growth Rates for the Period 1986 – 1996

	Country	State Money (M0) as a Proportion of Broad Money (M2) in 1996	Average Annual Growth Rate 1986 - 1996		
			Real GDP	Narrow Money (M1)	Broad Money (M2)
1	ARGENTINA	0.23	2.49	179.09	181.80
2	BAHRAIN	0.14	6.15	4.72	5.65
3	BANGLADESH	0.23	4.23	10.98	13.92
4	BELIZE	0.20	8.34	8.73	11.39
5	BOLIVIA	0.24	3.86	23.54	35.58
6	BOTSWANA	0.14	7.82	14.60	18.06
7	BRAZIL	0.23	2.57	591.80	677.76
8	BURKINA FASO	0.52	2.66	10.35	10.12
9	BURUNDI	0.43	-0.47	8.53	11.81
10	CAMEROON	0.31	-2.36	-3.57	-3.53
11	CHILE	0.88	7.89	25.06	24.68
12	CHINA,P.R.: MAINLAND	0.35	9.99	23.03	28.19
13	COSTA RICA	0.47	3.98	15.37	24.22
14	ECUADOR	0.21	2.62	40.81	53.45
15	EGYPT	0.30	4.20	10.79	17.13
16	EL SALVADOR	0.36	4.11	13.90	19.31
17	ETHIOPIA	0.42	3.90	10.98	13.59
18	FIJI	0.17	2.78	10.24	9.98
19	GHANA	0.50	4.64	36.25	38.56
20	GUATEMALA	0.27	3.88	18.55	20.11
21	HONDURAS	0.32	3.63	21.24	22.07

²⁹ Though the bank did not pay anything tangible in the first place.

25	JAMAICA	0.35	2.66	31.68	30.50
26	JORDAN	0.46	2.36	5.50	8.61
27	KENYA	0.33	3.30	16.25	21.70
28	KUWAIT	0.06	2.95	1.94	3.67
29	LESOTHO	0.25	28.04	15.13	14.17
30	MADAGASCAR	0.57	1.22	22.30	23.55
31	MALAWI	0.56	2.94	28.65	28.04
32	MALAYSIA	0.30	8.50	17.71	15.74
33	MALDIVES	0.63	8.45	18.82	20.26
34	MALTA	0.26	5.83	4.24	10.50
35	MAURITIUS	0.20	5.84	14.99	18.67
36	MEXICO	0.15	2.50	42.94	41.90
37	MOZAMBIQUE	0.37	4.29	42.99	49.40
38	MYANMAR	0.66	2.52	26.24	26.56
39	NEPAL	0.36	4.52	17.73	19.75
40	NIGER	0.51	1.60	0.89	0.32
41	NIGERIA	0.52	4.23	33.87	31.64
42	OMAN	0.20	4.43	4.87	6.46
43	PAKISTAN	0.33	5.26	13.78	15.92
44	PARAGUAY	0.38	3.69	26.88	32.71
45	PERU	0.40	1.15	240.04	271.95
46	PHILIPPINES	0.22	3.68	18.37	21.93
47	POLAND	0.25	1.10	68.76	74.15
48	RWANDA	0.49	-2.39	10.19	9.96
49	SAUDI ARABIA	0.21	2.92	4.43	4.90
50	SIERRA LEONE	0.51	-2.90	39.91	43.75
51	SOUTH AFRICA	0.09	1.56	20.33	15.15
52	SRI LANKA	0.34	4.31	14.02	16.99
53	SYRIAN ARAB REPUBLIC	0.56	5.62	14.84	16.74
54	THAILAND	0.12	9.43	15.26	18.69
55	TRINIDAD AND TOBAGO	0.22	0.27	5.84	6.82
56	TUNISIA	0.26	4.34	6.88	10.30
57	TURKEY	0.18	4.38	67.55	80.88
58	UGANDA	0.50	7.04	54.20	57.42
59	URUGUAY	0.31	3.59	59.82	62.51
60	VENEZUELA, REP. BOL.	0.42	2.60	40.81	39.85
61	ZAMBIA	0.25	1.25	61.09	67.28
62	ZIMBABWE	0.28	3.13	28.54	25.54
Average		0.34	4.25	36.92	41.40

Source: Meera (2004). Computed using data from IMF Financial Statistics Yearbook 2000. The growth rates are geometric means for the decade 1986-1996, avoiding the 1997 East Asian economic crisis period.

4. Mathematical Model: Why Loans are Non-Repayable in Aggregate (i.e. Why defaults are sure to take place)

Let us introduce the following notations

- (1) X = the initial amount of money lent to the players.
 - (2) $I = \{1, 2, \dots, n\}$ is the set of players
 - (3) α_i = the initial debt of player i , $i = 1, 2, \dots, n$
 W_i = the real asset of player i or his wealth or the maximum level of debt that he can bear.
 - (4) α = the rate of interest, $\alpha \in]0, 1[$
 - (5) β_i = the amount by which the debt increases at the end of the period (for example 1 year)
 - (6) I_1 = the set of players who reimburse at the end of period
 - (7) I_2 = the set of players who didn't reimburse at the end of period
 - (8) D = total debt of all players (or aggregate debt) generated by interest
 - (9) G = the global (or aggregate) debt of all players
 - (10) R = the global amount of money reimbursed at the end of period by all players.
- Now let us give some relations between the defined above quantities.

Remark 1. From (1)-(10) we deduce

$$(11) \quad X = \sum_{i=1}^n \alpha_i = \sum_{i \in I_1(t)} \alpha_i + \sum_{i \in I_2(t)} \alpha_i \quad \text{and} \quad I = I_1 \cup I_2,$$

$$(12) \quad D = \sum_{i \in I} \beta_i$$

$$(13) \quad G = X + D$$

Generally banks do not lend more than the borrower's wealth, that is $\alpha_i \leq W_i$, for in case of bankruptcy, it can get back the money lent. It is to be noted that if the borrower i defaults for

following number of periods $n = \frac{\text{Log} \frac{W_i}{\alpha_i}}{\text{Log}(1 + \alpha)}$ (if this number is not integer, take the integer part

plus one) the debt will reach his wealth, then the bank can confiscate all his wealth if it wants. Since the interest rate α (4) is strictly positive then the global debt generated by interest D is also positive according to (12). Taking into account the fact that only the amount of money X is available for players and the money corresponding to the aggregate debt D generated by interest doesn't exist in economy, we conclude that

$$(14) \quad R \leq X < X + D = G$$

Thus

$$(15) \quad R < G$$

The relation (15) means that the amount of money reimbursed in aggregate is always less than the amount of money to be reimbursed in aggregate, that is, the players will surely default in aggregate.

Now let us assume that the bank doesn't confiscate real wealth of players, then the second period starts with the following amount of money available in economy

$$(16) \quad X_2 = X - R$$

Assuming the bank does not spend the R into the economy. And the aggregate debt

$$(17) \quad S_2 = G - R$$

Since interest will be charged on this debt, then the aggregate debt D_1 generated by interest in second period is strictly positive and the global debt in the second period will be

$$(18) \quad G_2 = S_2 + D_2$$

Similarly, since $D_2 > 0$, the aggregate amount of money R_1 reimbursed by players at the end of the second period verifies the following relation

$$(19) \quad R_2 \leq X_2 < X_2 + D_2 = G_2$$

Hence

$$R_2 < G_2$$

Thus, in the second period also the default in aggregate will surely take place. By the same reasoning we can prove that at any period the default will surely occur in aggregate³⁰.

Conclusion

Having said that money is primarily introduced in the form of loan with interest charges attached, it is important to recognize that total debt (principal plus the interest) is, therefore, not repayable in aggregate. Accordingly, in the aggregate analysis, default is for sure by the mere design of the system. This is fundamentally due to the fact that the interest portion that needs to be repaid together with the principal, does not exist in the form of money. As mentioned earlier, this fact is very crucial as it has a number of serious consequences and implications. For example, assume that there is a total of RM10 billion money supply in the form of loan, given out at an interest rate of 10 percent. At the end of the period RM11 billion (i.e. 10 billion plus interest of 1 billion) need to be repaid. However, only RM10 billion actually exists in the form of money. The money needed for the interest portion does not exist. If additional money to the amount of RM1 billion is not created and introduced into the system, then some borrowers are bound to default on the loan. Therefore, in this system three things may take place in order to sustain it dynamically³¹: 1. Additional money in the form of loans be created and given out to the defaulting units (i.e. rescheduling loans). This, of course, would increase further the indebtedness of the borrower. 2. Additional paper money and coins can be introduced by the government to the extent of the interest money. 3. The bank confiscates real wealth (e.g. collateral and others) from the defaulting

³⁰ Nonetheless, such aggregate default is 'camouflaged' when players repay loans piecemeal in instalment basis and as bankers spend back the money into the system.

³¹ This section draws from the author's book, Meera (2004).

borrower. The former two would cause money supply in the economy to grow further. The third option transfers real wealth from the borrower to the banker.

The first option causes money in the economy to grow in the form of debt – private sector debt and public sector debt, thereby causing these sectors to become increasingly indebted to the banking sector and in aggregate, actually deferring a higher default amount to a later date. The banking sector, having the power to give additional loans, effectively controls the ‘life-line’ of the private and public sectors since it can decide which defaulting unit (for some units are sure to default by the design of the system) it would save (by giving additional loans) and which it would let fail.

While the present system can be sustained only dynamically by a continuous increase in money, it is bound to collapse ultimately because debt has financial implications on the capital structure of the economy.

While debt financing is attractive to firms because generally it is cheaper, interest payments are tax deductible and it, therefore, increases the return on equity (ROE), the problem with debt financing is the cashflow commitment one has to give to service the debt – the constant periodic repayment, but the cashflow from normal business operations is rather risky. How much debt a firm can go for, therefore, depends on its business risk, with businesses having good cashflows being able to go for higher debt levels. Nevertheless, it is important to observe that, on average, businesses bear risks higher than the debt itself (that demands a riskless payback).

Since money grows in the form of debt in the current monetary system, businesses and governments would, therefore, increasingly become indebted until a level is reached that it cannot be borne any longer. When firms in the economy cannot bear it any further, they would collapse³². The effects of such collapse are that real wealth and sovereignty would gradually shift to those who create fiat money, i.e. those who directly benefit from its seigniorage. The stakes in the current interest-based fiat monetary system is summarized in Figure 1³³. It is not difficult to see that a serious ‘defect’ of the current monetary system is where fiat money is introduced primarily as debt into the economy with interest charges attached, that brings about further increases in debt until the whole system becomes unsustainable and, therefore, ultimately collapses.

Indeed, we regret to state that the Islamic bank operating within the fractional reserve system is equally or more detrimental to the economy than the conventional system³⁴. Rather it is easy to see why this is so. Consider the following example. Assume that two similar houses priced at RM200,000 were financed using the Islamic and conventional methods respectively. Also assume that the APR in both cases is 10 percent per annum and the duration of financing is for 20 years. Now consider how the mechanisms work. Both the Islamic bank and the conventional bank would create the RM200,000 through the fractional reserve banking system. Indeed this is new money created for the first time, and not anybody’s deposit. It is through the seigniorage of this new RM200,000 that both the banks would finance the transaction. The conventional bank basically lends the money at interest while the Islamic bank purchases the house and sells it again to the customer at a profit.

³² We attribute the failure of large firms like Enron and Xerox to this. In Japan lately, for example, while the government suggested the buy back of bad debts with M0 i.e. state money, the bankers opposed and proposed the monetization of shares instead (i.e. effectively confiscating real wealth). When governments get into such trouble, they too can collapse, i.e. likely to get replaced. There are many examples for this – Argentina is a recent example.

³³ Reproduced from Meera (2004).

³⁴ This statement is without prejudice towards our *Shari’ah* scholars who have contributed greatly towards the development and monitoring of *Shari’ah* compliant financial instruments.

The monthly payment for the above financing is RM1930.04 in both cases, payable for 240 months (i.e. RM463,210.38 in total). The Islamic bank considers the RM463,210.38 as the selling price of the house. The difference between this figure and the original principal amount of RM200,000 which equals RM263,210.38 is the total interest paid in the conventional financing while it is the total profit under the Islamic financing. While both banks created the principal RM200,000 out of thin air, the difference is this: The profit of RM263,210.38 is capitalized upfront in the Islamic mode while in the conventional mode the total interest is not. To demonstrate this, let's work-out the balance of the financing that would remain in both cases after 10 years (120 payments). Under the conventional system it is the present value of the remaining 120 monthly payments, i.e. RM146,048.62 but in the Islamic mode the balance is the total of the remaining 120 payments, i.e. RM231,605.19! Therefore, the difference in the balance between the two modes is that the customer owes RM85,556.57 more under the Islamic mode³⁵. Note that even after ten years of repayment, the balance under the Islamic mode can even be more than the original financing of RM200,000 (See Figure 2). This never happens under the conventional financing where loan balances at any point in time never exceeds the principal amount. Therefore, under fractional reserve banking system where both the conventional and Islamic banks create money out of nothing, the Islamic mode is indeed more attractive to the bankers. Hence, one should not be surprised at the enthusiasm and zeal of all bankers, Islamic and conventional alike in promoting Islamic financing. Nevertheless, considering all the socioeconomic effects of fiat money, we are helpless but to conclude regrettably that Islamic banking under fractional reserve system is indeed more damaging to the economy³⁶. Note that this conclusion is arrived by questioning the nature of money, i.e. *what is money* and not by questioning the *Sharī'ah* compliance of the mode of financing. What constitutes money in *Sharī'ah* is, therefore, equally important (for it is directly related to the concept of *riba*) as the question of sources, uses and modes of Islamic financing (that have been widely addressed by *Sharī'ah* scholars).

Seigniorage and Interest at the International Level

The previous argument showed how in the domestic scene real wealth and sovereignty get transferred to those who create fiat money. Now with similar arguments on the global platform with countries as players, on aggregate default is for sure. Therefore, the mathematical model of Section 4 is also valid at the international level. This is because, for example, say a country A takes a loan denominated in dollars from an international financial institution. In aggregate then, the system must create additional dollars for otherwise the loan is not repayable (note that other existing dollars have also been loaned into existence, thus putting other debtor countries in a similar position). Since the borrower countries have no power to create dollars³⁷, the borrower countries must compete for the existing dollars circulating worldwide. Competition for dollars is, therefore, tough since there are not many countries anyway³⁸. Hence such borrowing can be "deadly" for developing nations since their global competitiveness is generally not that good. In this way, developing nations tend to become heavily indebted and thereby lose their wealth and sovereignty easily to these international financial institutions.

³⁵ The Islamic bank may give some rebate for the early repayment, but the amount of rebate is determined at the discretion of the bank.

³⁶ While Meera & Iarhani (2004) argued that both Islamic and conventional banking systems would ultimately converge due to arbitraging between both the banking systems, Islamic banking would continue to exist, or even further popularized by the finance industry at least for the above reason.

³⁷ Unlike gold, for example, where no country enjoys the monopoly over its production.

³⁸ Thereby increasing the probability of default.

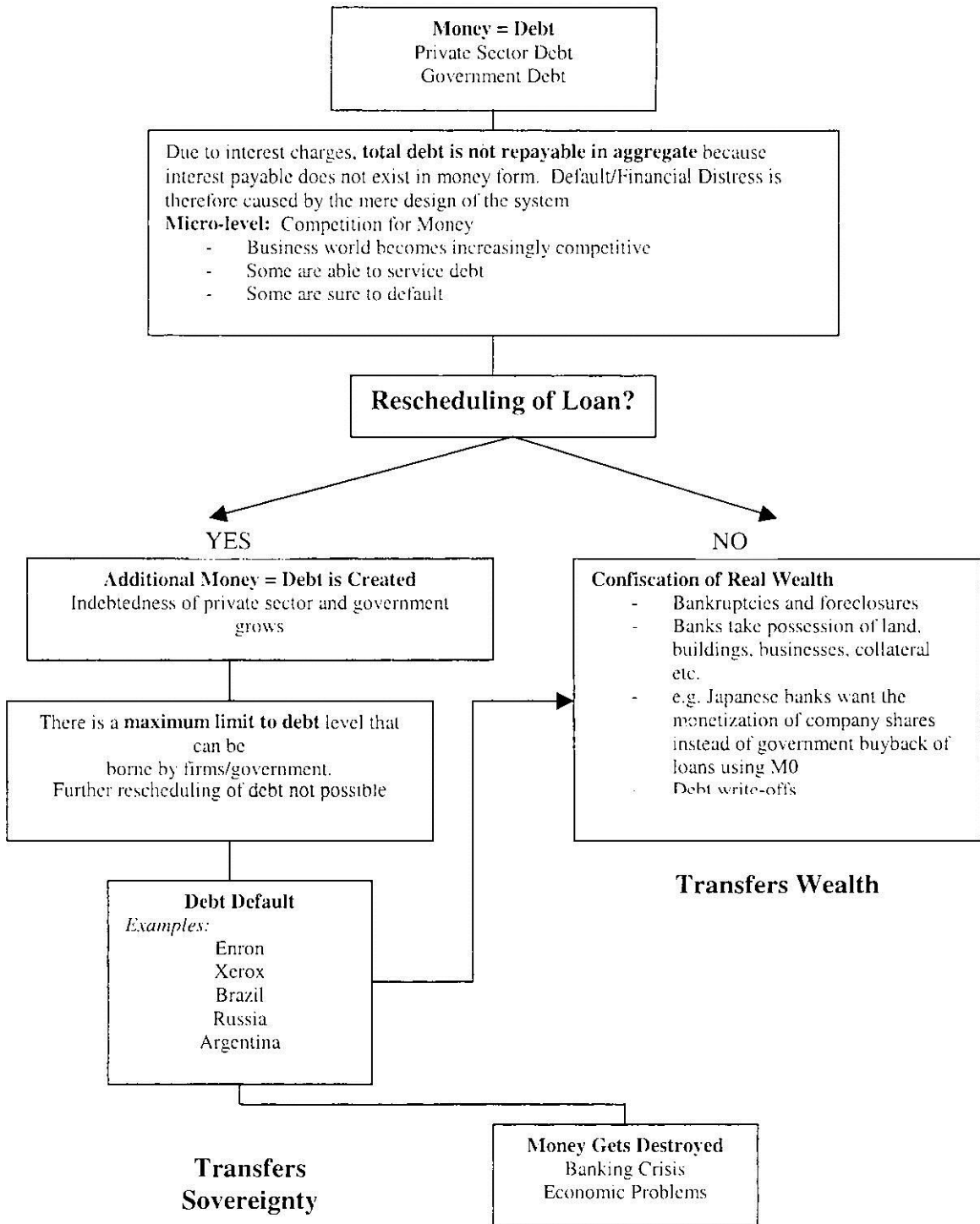
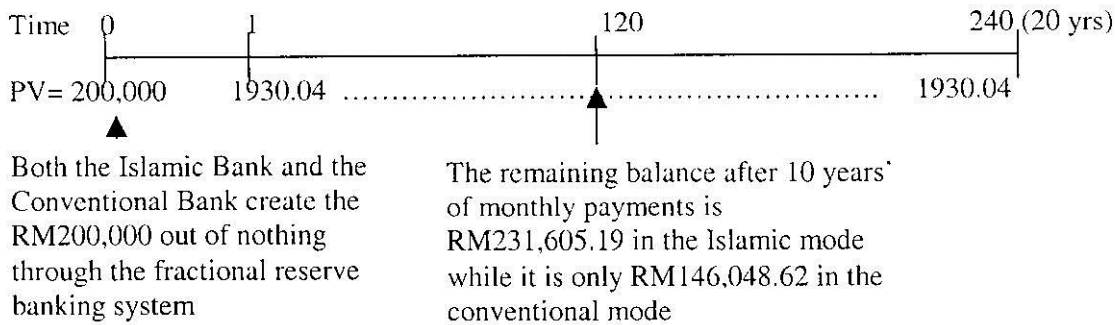


Figure 1: Flowchart Showing Stakes in the Present Monetary System

Figure 2

Islamic Banking and Conventional Banking under Fractional Reserve System



While both the Islamic bank and the conventional bank create the original principal amounts of 'loans' through fractional reserve banking system (i.e. loans given out do not really reduce the deposits of the depositors), a customer owes more money in the Islamic mode than the conventional mode at any time thereafter until the 'loan' is settled. This fact alone is very attractive for even conventional bankers to provide Islamic mode financing. But, nonetheless, considering the serious negative socio-economic implications of fiat money-based fractional reserve banking, we regretfully conclude that Islamic banking under fractional reserve system is likely to accelerate the said effects – the default rates, the transfer of wealth and sovereignty etc.

In the present global monetary system with some currencies playing the role of international reserve currencies, **developing nations including almost all Muslim nations lose tremendously due to this seigniorage**. Resources of the developing nations are being plundered through this system, i.e. through the magic of seigniorage. An international currency like the dollar, therefore, enjoys immense advantage through seigniorage. Since it has purchasing power outside the United States, additional money can be created for use outside the country without placing undue inflationary pressure domestically. In this era of globalization and neo-liberalization, therefore, interest-based fiat money systems no longer work to the advantage of developing nations. The entire process occurs subtly and gradually since interest is based on time. The system basically enslaves the masses³⁹. The entire system is akin to "slavery" where 'development' would still be observed, but the ownership of assets and sovereignty gradually gets eroded and transferred away. Therefore, the seigniorage of fiat money has implications for **ownership** of assets in the economy.

Since the collapse of the Ottoman caliphate in 1924 and the triumphant entry of fiat money and interest, Muslim nations must have lost huge amounts of wealth through the seigniorage of fiat money, particularly to the colonial masters, and the bankers whom they had placed, before they left.

³⁹ Slave-based economies would depict faster economic growth and development because slaves are generally overworked to produce goods and services. But the problem with slave-based economies is that the slaves are not the beneficiaries of the development, i.e. they are not the owners of what they produce. Ownership goes to their masters. Similarly, the enslavement of the masses by the *riba*-based economies would also bring about faster development, but again it is a question of ownership and justice. Significant portion of the efforts and production of the people goes to the creators of fiat money.

The Unattainableness of the *Maqasid al-Shari'ah*: Protection of Wealth (*Mal*) - The First of the *Maqasid* to Suffer

Therefore, it is obvious that in the interest-based fiat money system, the protection of wealth, which is one of the *maqasid al-Shari'ah* suffers. Individuals and sovereign governments are, therefore, likely to suffer particularly in this era of globalization and neo-liberalization. As wealth accumulates in the hands of fiat money creators, sovereignty would also be lost. Sovereignty is indeed linked to the other *maqasid*, i.e. the protection of faith, life, intellect and progeny and these would also be affected. This is because when sovereignty is lost in a land, then the new 'rulers' may impose things that directly or indirectly affect the other *maqasid*. History has a number of evidences for this. When sovereignty was lost in Muslim lands, the education system was changed, i.e. affecting the intellect ('*aql*). Today foreign forces are even asking Muslim nations to change their education curriculum, while some are even closing down religious schools. Muslim women and children are even prohibited to wear the *hijab*. Even the *athan*, the call to prayers using loudspeakers have been prohibited in some cases. Of course, affecting the education and interfering in the practice of the religion can in turn affect faith itself. Also the inability to protect wealth could also lead to the lack of faith. Such an important link between wealth and preservation of faith can also be deduced from the following sayings of the Prophet (peace be upon him):

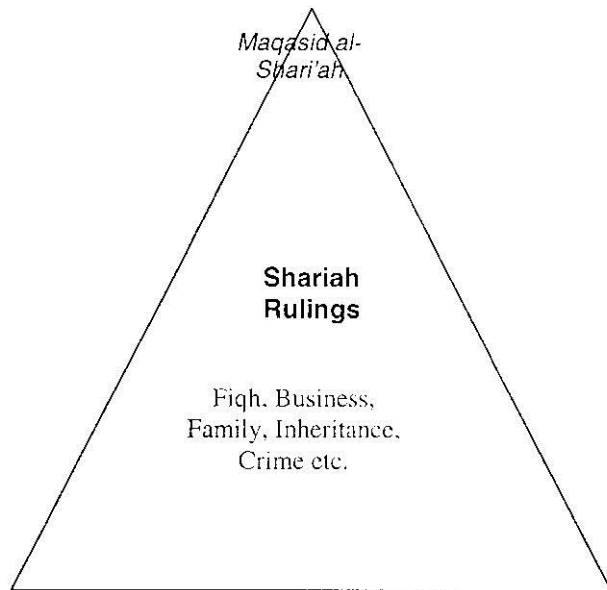
Poverty, in all probability, leads to unbelief (kufr).

(Baihaqi and Tabarani)

There are also attempts to limiting the population growth of Muslims, citing the reason that per capita income would be better with smaller populations. In some countries, even birth contraceptives are being distributed free in order to curb Muslim population growth. This of course affects the *maqasid*, i.e. the protection of life and progeny.

From these, it is obvious that in the interest-based fiat money system, firstly Muslims will not be able to protect their wealth. Thereafter, they are likely to lose sovereignty and thereby lose the other *maqasid of al-Shari'ah* (See Figure 3).

Figure 3
Fiat Money and the Unattainableness of the Maqāsīd al-Sharī'ah



Shari'ah rulings that encompass *fiqh*, business, family, inheritance, crime etc. are meant to achieve the *maqāsīd al-Shari'ah* that bring about welfare in this world and the hereafter. Nonetheless, fiat money negates the attainment of one of the *daruriyyah* elements of the *maqāsīd al-Shari'ah*, i.e. the protection of wealth, thereby, causing the loss of sovereignty which, in turn, causes the loss of the other *maqāsīd*, thereby rendering *Shari'ah* inferior.

The 'Hidden Tax' and Other Socio-Economic Effects of Seigniorage

Since the initial effect of money creation is an increase of money supply relative to the real economy, it therefore, entails a 'hidden tax' on the entire economy, the rich and the poor alike (in the form of inflation). Nonetheless, the poor are likely to suffer more since they generally have low savings. Also the newly created money is likely to go to the rich first⁴⁰. In Islam, wealth transfer is always from the rich to the poor in the form of zakat, charity etc. But seigniorage of fiat money taxes the poor and transfers wealth from the poor to the rich. Additionally, interest charges concentrate wealth in the hands of a small minority by taxing the majority⁴¹. Such concentration and circulation of wealth among the rich is discouraged in Islam.

In order that it (wealth) may not (merely) make a circuit between the wealthy among you...

Qur'an (Al-Hashr 59:7)

This concentration of wealth, in turn, would cause less and less money to circulate in the economy thereby bringing about numerous socio-economic problems associated with low circulation of money that includes unemployment. The society would then tend to compete for money whose circulation keeps decreasing.

⁴⁰ The rich are more likely to get a loan from the bank since they are socially and economically closer to the bankers.

⁴¹ See Lietaer (2001) for arguments and evidence for this.

This effect, taken together with inflationary nature of fiat money, would cause a section of the economy to experience falling real income, thereby bringing about increased disparity in income distribution, creating relative and absolute poverty. This disparity in income distribution is something to be concerned about for it brings about with it a host of socio-economic problems. Using the *equation of exchange*, Meera (2002a) argued that such problems include inflation, unemployment, widening income distribution gap, housing for the low-income group, agriculture, poverty, crime etc.

Since the property sector is one of the sectors that absorb the increasing money supply, the price of homes can thus be expected to grow at a rate higher than the average income growth. This can pose some housing issue problems⁴².

The struggle to survive in the economy, particularly by those at the lower strata may cause them to resort to corruption, crime etc. Therefore as the system creates poverty, it is also likely to bring about social evils including anomie (i.e. erosion of traditional values). Hence crime is likely to become part and parcel of the interest-based fiat monetary system.

With all the negative effects of fiat money we truly assert that the creation of fiat money is a serious form of *riba*. It is, therefore, not surprising to note some of the observations made by prominent economists. Consider the following: Chapra states⁴³:

The Islamic economic system does not prevail in any part of the Muslim world. The Muslim countries have been trying to solve their economic problems through policies developed within the secularist perspective of the prevailing systems. Their problems have become aggravated and **they have moved farther and farther from the realization of the *maqasid***.⁴⁴ Despite a rise in gross domestic product, poverty has not declined; rather it has risen. Inequalities of income and wealth have also worsened, and the basic needs of their people remain unsatisfied. The public sector budgetary deficits have risen, as have balance of payments deficits and external debt, and the threat of inflation persists.

While the World Bank was established more than half a century ago (in 1944), with the motto *Our dream is a world without poverty*, its former chief economist, Nobel Laureate, Joseph Stiglitz wrote the following⁴⁵:

A growing divide between the haves and the have-nots has left increasing numbers in the Third World in dire poverty, living on less than a dollar a day. Despite repeated promises of poverty reduction made over the last decade of the twentieth century, the actual number of people living in poverty has actually increased by almost 100 million. This occurred at the same time that total world income actually increased by an average of 2.5 percent annually.⁴⁶

All institutions that create fiat money are, therefore, responsible for the above observations. Such institutions include, governments via central banks, commercial banks including Islamic banks via multiple credit creation, the IMF and IDB with their overdraft facilities (SDRs and the Islamic

⁴² The housing issues include: a) Housing for low and middle income group. If the price of housing is not controlled, the money-creating system would place a burden on the low-income group. b) Size of homes shrinks gradually. Property developers build smaller and smaller sized homes so as to make them affordable. c) Duration of loans extended. The banking sector 'helps' by giving longer durations to settle housing loans.

⁴³ Chapra (1992), p.9.

⁴⁴ Emphasis ours.

⁴⁵ Stiglitz (2002), pg.5.

⁴⁶ Emphasis ours.

Dinar respectively), the World Bank, indirectly, by issuing bonds to commercial banks and also currency counterfeiters.

Conclusion

In concluding, we assert that the protection of wealth, a *daruriyyah* component of the *maqasid al-Shari'ah* cannot be preserved under the interest-based fiat monetary system. While Islam does not emphasize on the accumulation of wealth, yet nevertheless, the protection of wealth is considered *daruriyyah*. This is an important contention, because wealth has sovereignty attached to it. The loss of wealth can bring about a loss of sovereignty, and with sovereignty lost, other *maqasid* will also suffer.

Therefore, we assert that fiat money creation is a profound *riba* and in a fiat monetary system, Muslims have a lot to lose. Muslim aspirations for the Islamization of knowledge/disciplines, which includes Islamic economics, banking and finance can never be truly established in this environment. These aspirations would be reduced, therefore, to mere classroom discussions. It is, therefore, imperative for Muslims to address the seigniorage of fiat money and recognize it as a gigantic yet devastating *riba*, before truly Islamic systems can again be aspired for. As Muhammad Asad wisely puts it in his commentary to the Holy Qur'an⁴⁷:

...while the Qur'anic condemnation of the concept and practice of *riba* is unequivocal and final, every successive Muslim generation is faced with the challenge of giving new dimensions and a fresh economic meaning to this term ...

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⁴⁷ Asad (1980), commentary to the verse al-Rum (30:39), f.n. 35.

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SEIGNIORAGE OF FIAT MONEY AND THE *MAQASID AL-SHARI'AH*: THE COMPATIBILITY OF THE GOLD DINAR WITH THE *MAQASID*

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Abstract

Part I of the paper argued that fiat money is counterproductive to the attainment of the *maqasid al-Shari'ah*. In the present interest-based fiat monetary system one of the *maqasid*, namely, the protection of wealth (*mal*) cannot be realized, which in turn causes the other *maqasid* to be affected too. In this Part II paper we argue for commodity monies, like the gold *dinar* and silver *dirham*, as being compatible with the *maqasid*. Basically the paper concludes that the Islamic economic system is fundamentally a 'barter' system, i.e. an exchange economy where goods and services are exchanged value for value; but avoids the problems associated with barter by taking some of the commodities exchanged in the economy, that have the characteristics of money, as money; and gold is here argued as the best *Shari'ah* money.

Introduction

Part I paper⁴⁸ highlighted the many problems faced in present day economies particularly by developing nations due to the very definition or the nature of money itself — i.e. fiat money that has no intrinsic value of its own, but nonetheless deemed 'legal tender'. Since fiat money of today comprises of primarily accounting entries⁴⁹, it is created easily and in certain circumstances is also destroyed easily⁵⁰. This unreal or virtual feature of fiat money has numerous implications for the economy particularly in the context of stability and justice. This system, nevertheless, benefits the minority in whose hands the control of the financial institutions rests, i.e. those who have the power to create fiat money and distribute the purchasing power thereon created (by means of loans or otherwise). Part I paper argued that the system, therefore, gradually accumulates wealth and sovereignty into the hands of this minority. Interest charges also pose structural problems in the sense that they necessitate more and more fiat money to be created simply to sustain the system, apart from causing wealth to accumulate and circulate among the rich in the society. Some of the socio-economic problems caused or worsened by the interest-based fiat money system were also mentioned in the Part I paper. We concluded that under interest-based fiat money system, the *maqasid al-Shari'ah* indeed cannot be realized. The paper traced the source of the problem to the

⁴⁸ Meera and Larbani (2004), 'Seigniorage of Fiat Money and the *Maqasid al-Shari'ah*: The Unattainableness of the *Maqasid*'

⁴⁹ Demand deposits created through fractional reserve banking.

⁵⁰ When borrowers pay back loans or default on loans, for example.

seigniorage of fiat money, which was argued to be a profound *riba*, embedded both in the creation of fiat money and the interest charges thereupon demanded.

If fiat money, which Muslims have taken for granted all along, is not *Shari'ah* compatible, then the question arises: What then is money in *Shari'ah*? What are the characteristics of money in Islam – that can assist in the realization of the *maqasid*? Before we delve into the question *what may constitute money in Shari'ah*, let us glance over the normal functions of money.

Production, Trade and Money: The Catalysts for Economic Growth and Well-being

Production and trade, no doubt had improved the economic wellbeing of mankind. With trade one is able to enjoy more goods and services, through specialization, which otherwise may not be able for one to produce oneself. However, a barter economy poses a number of problems; double coincidence of wants is one of them⁵¹. Introducing money into the system, nevertheless, not only solves the problems inherent in barter trade, but also promotes specialization, encourages trade and improves the overall well-being of people. Money is, on the other hand, generally anything that is accepted as payment for goods and services or debt. Normally, people only refer to currency (paper notes and coins) as money but, technically, it is anything that is accepted as a medium for payment. In ancient times, people had even used rocks, leather, salt, shells, etc. as money. These were later replaced by precious metals like gold and silver which played the role of money better for a considerable span of time in human history. After Bretton Woods ended in 1971, paper money and electronic money have become the dominant forms of money globally.

The primary function of money in the economy is, of course, as a *medium of exchange*, i.e. used for paying for goods and services. This simple function is, nevertheless, responsible for promoting specialization and accelerating trade among people; and thereby, elevating the standards of living for the people. The function of money as a medium of exchange, therefore, brings about a high degree of economic efficiency. In a barter economy efficiency is much suppressed and, therefore, the standards of living would be necessarily low.

With the introduction of money, the problem of 'double coincidence of wants' is eliminated. One sells goods or services for money and then uses it to buy whatever other goods and services one desires. Divisibility of money makes the exchange of different quantities of items possible and yet simple. Money thus allows one to specialize in whatever one does best. This increases the productivity, quantity and quality of goods and services produced and exchanged in the economy.

For an item to function effectively as money, the following five characteristics are normally mentioned as should be present:

1. Standardizable such that its value can be ascertained easily.
2. Accepted widely. This function requires money to be something that has its own worth or intrinsic value. The rarer the item the better (so that a small quantity can fetch high value). Since fiat money has no intrinsic value of its own, it is made 'acceptable' by means of law, and hence the term 'legal tender'.
3. Divisible, so that it can be used for the exchange of a range of values.
4. Mobile, i.e. easy to carry around.
5. Stable/Durable, so that it does not deteriorate, perish, deplete or erode easily due to its own chemical structure, weather, pest, fire or other reasons.

⁵¹ That is, the need for one party to find a counter party who would be willing to accept what one has to offer and in return has what one wants, in agreed proportions.

A good monetary system should encourage the circulation of money rather than the hoardings of it. In normal circumstances, a high velocity of money circulation would encourage increased economic activity and productivity. Hoarding, on the contrary would slacken economic activity, which show up in the form of poor demand, low business activities and profits, business failures, unemployment, etc.

The second function of money is as a *unit of account*. This refers to its use as a measure of value in the economy, e.g. \$50 being the price of a shirt or \$2 being the price of kilogram of sugar and so on. This function eliminates the need to quote the barter exchange prices between every pair of goods and services that exist in the economy.⁵²

The third function of money is as a *store of value*. This refers to the purchasing power of money over time. If money is a good store of value, then its purchasing power should be preserved from the time money is received until it is spent. If \$1,000 today can buy a basket of goods, and if a year later it can buy the same basket of goods, then money has been a good store of value in that year⁵³. In contemporary financial systems, money is not a good store of value since its value generally depreciates over time, i.e. its purchasing power erodes due to inflation.

The Part I paper postulated that the following characteristics of the present monetary system, i.e. fiat money, fractional reserve banking and interest charges as being at the root of the instability and unjustness of the system⁵⁴. We argued that these characteristics, indeed, negate the attainment of the *maqasid al-Shari'ah*. The opposites of those three characteristics are of course: real money, 100 per cent reserves and negative interest rates (e.g. *zakat* or demurrage charge)⁵⁵. A negative interest rate encourages money to be spent and kept in circulation rather than being hoarded. If the earlier characteristics were shown to prevent the attainment of the *maqasid al-Shari'ah*, could the opposites of those be then compatible with *Shari'ah* money?

We argue in the next section why real money and negative interest rates are indeed characteristics of Islamic monetary system.

⁵² In a barter economy with one hundred goods for example, 4,950 pairs of prices need to be quoted, i.e. C_2^{100} . With money, however, the 100 items will have their respective price each, and therefore, only 100 prices need to be there.

⁵³ Of course, relative to that basket of goods.

⁵⁴ See Meera (2002) for further elaboration.

⁵⁵ Many past Muslim scholars and contemporary works like Choudhury (1997 & 2002) and Meera (2002) assert the importance of real money and 100 percent reserve requirement in order to truly match the monetary sector with the real sector. Lietaer (2001) and Meera (2004), for example, show the importance of replacing positive interest rates with negative interest rate. Lietaer (2001) and Greco (2001), for example, show how alternative real money systems have been used by communities around the world to foster sustainable development.

Table 1

Characteristics of Fiat Money and Problems Caused⁵⁶

<p><i>Creation of Fiat Money Out of Thin Air</i></p> <ol style="list-style-type: none">1. Causes inflation and asset price bubbles.2. Debt bubbles and financial collapses of firms and governments.3. Amplifies business cycles.4. Trade-off between inflation and unemployment.5. Agriculture sector disadvantaged due to price controls in this sector.6. Along with interest rates, it places the burden of a continuous growth requirement, intensifies competition and accumulates wealth in the hands of a minority by taxing the majority.7. Widening gap in the distribution of income - creates poverty and social problems like housing, long working hours, multiple jobs, female and child labour, corruption, crime, etc.
<p><i>Destruction of Fiat Money in Certain Circumstances</i></p> <ol style="list-style-type: none">1. Causes a shrink in money supply and aggregate demand, and thereby triggers economic problems like recession with business failures, unemployment etc.2. Bank failures and financial crises.3. Leaves governments in debt.4. Possible political turmoil.
<p><i>The Existence of Many Fiat National Currencies</i></p> <ol style="list-style-type: none">1. The many fiat national currencies currently existing, provide a fertile ground for currency speculation, manipulation and arbitrage.2. Makes possible for huge amounts of short-term funds (particularly electronic money) to move in and out of nations within seconds. This fact is very destabilizing.3. Through the seigniorage of fiat money some nations gain substantially when other nations use their currency for international trade and dealings or in domestic transactions.4. Provides an easy tool for domestic and international financial institutions to gain control over money, wealth, the political structure (i.e. sovereignty) of nations, etc.

Real Commodity Monies: The Viability of Gold as Money

The opposite of fiat money is, of course, real money, i.e. money that has intrinsic value. This necessarily has to be commodity based, i.e. money which itself is a commodity valued by people or money that is backed by such commodities. Indeed, historically mankind has used a number of commodities as money – cowry shells, salt, leather, gold and silver to name a few. But in later periods, gold and silver dominated money. The gold dinar and silver dirhams were the dominant money during the early days of Islam and for the most part of the Muslim history. Commodity money, unlike its fiat counterpart, cannot be created out of nothing. We argued in Part I paper that fiat money is easily created by the banking sector and that the growth in money supply is necessary simply for the sustainability of the system. It also highlighted the many problems inherent in the interest-based fiat monetary system. The problems may be matched with the characteristics of fiat money as summarized in Table 1.

A commodity money is not likely to cause the above problems simply because it cannot be created the way fiat money is easily created. A commodity is, in contrast, physical and real. It can neither

⁵⁶ Source: Meera (2002) and Meera (2004a).

be created at the will of anyone nor be counterfeited⁵⁷. This characteristic alone can obviate most of the problems associated with fiat money — hyperinflation, asset price bubbles, debt bubbles, amplification of business cycles, etc.

If a commodity like gold were used as a common currency instead of the different national currencies, then there would be no exchange rates in the first place. Therefore, speculation, manipulation and arbitrage would no longer be possible. The possibility of the kind of currency attacks that the East Asian countries experienced in 1997-98 would be very much diminished.

Also if gold were to become a common currency, no individual country can enjoy substantial seigniorage, like the seigniorage of international currencies. Accordingly, gold protects the sovereignty of nations⁵⁸ and thereby, in turn, also protects their culture, religion, education, legal structure, etc.⁵⁹.

A number of 'real money' solutions are currently being discussed, examples of which include: (1) gold and silver money, (2) a basket of commodities as money,⁶⁰ (3) complementary currencies⁶¹ and (4) Real Money Units (RMU).⁶² In our opinion, any real money would, in one way or another, provide some solutions to the above problems. Indeed, the historical Islamic economic system was fundamentally a barter economy, i.e. one that exchanged real goods and services. Nevertheless, some commodities in the economy, with the right characteristics, played the role of 'money'; and thereby prevented the problems generally associated with barter.

Abu Saïd al-Khudri reported Allah's Messenger s.a.w. as saying: Gold is to be paid for by gold, silver by silver, wheat by wheat, barley by barley, dates by dates and salt by salt, like for like, payment being made on the spot. If anyone gives more or asks more he has dealt in riba. The receiver and giver are equally guilty. (Sahih Muslim)

Also consider the following hadith⁶³:

Yahya related to me from Malik that Yahya ibn Sa'id said, "The Messenger of Alla, s.a.w., ordered the two Sa'ds to sell a vessel made of either gold or silver from the booty. They either sold each three units of weight for four units weight of coins or each four units of weight for three units weight of coins. The Messenger of Allah s.a.w. said to them, 'You have taken usury', so they returned it"

The commodities mentioned in the above *uhadith* have the characteristics of money as discussed earlier, are to be exchanged weight for weight. Table 2 below summarizes the characteristics of these 'money-commodities' mentioned in the sayings of the Prophet s.a.w., as per our judgment.

As for the *Homogenous and Standardizable* characteristic, we give a grade of *good* for the food items, i.e. dates, wheat and barley because these items can easily be recognized and graded. But we grade *excellent* for salt, gold and silver due to their fineness (in texture). For *Acceptability*, we grade *excellent* for gold due to its international acceptability⁶⁴. For silver we grade *very good* since it had historically played the role of money for a long period. Many gold proponents still talk

⁵⁷ Some may argue that sudden discoveries of gold can be inflationary. Please see section 4 for a counter argument.

⁵⁸ Particularly the vulnerable developing nations.

⁵⁹ As argued in Part I paper.

⁶⁰ See Lietaer and Nerb (2002).

⁶¹ Examples include the Austrian Worgle, Thai Bia, German WARA, Swiss WIR, New Zealand 'Green Dollar' and Local Exchange Trading Systems (LETS). For a discussion on these, see Bernard Lietaer, *The Future of Money*, Century, 2001.

⁶² See Bawany (2002).

⁶³ Aisha Bewley (trans.) (1989). *Al-Muwatta*. p.256.

⁶⁴ In fact, gold is the only commodity held by central banks as reserve asset.

about its possible comeback. For the food items, i.e. dates, wheat, barley and salt we provide a grade of *good* since they don't enjoy international acceptability. For example, dates may not be desired in some cultures.

As for *Mobility*, we give all the items a grade of *good* since they all can be moved location easily. As for *Stable and Durability*, gold and silver enjoy an *excellent* grade since both can last for very long periods unlike the food items that can perish due to bacterial activity, fungus, pest, fire etc.; and indeed these items are also destroyed in the process of consumption.

As for *Rarity*, of course, gold enjoys an *excellent* grade while we give a *good* grade to silver, which is available in a slightly higher quantity. For the food items we give a *fair* grade since they are available in much larger quantities and can also be cultivated. Nevertheless, unlike fiat money, all the above commodities cannot be created out of nothing.

Table 2
Commodities with Money Characteristics

	Homogenous/ Standardizable	Acceptability	Divisible	Mobile	Stable/ Durable	Rare
Date	Good	Good	Good	Good	Good*	Fair
Wheat	Good	Good	Good	Good	Good*	Fair
Barley	Good	Good	Good	Good	Good*	Fair
Salt	Excellent	Good	Excellent	Good	Good*	Fair
Gold	Excellent	Excellent	Excellent	Good	Excellent	Excellent
Silver	Excellent	Very Good	Excellent	Good	Excellent	Good

*These items are perishable through bacterial activity, fungal, pest, water, fire etc. and are also destroyed in the process of consumption.

From the above comparison of the characteristics, gold and silver dominate the other items in terms of durability, homogeneity, divisibility, rarity and global acceptance. Hence these two metals are also capable of playing the role of international money. Indeed, the most well-known commodity monies in the history of mankind are gold and silver. Gold as *Shari'ah* money is not something being asserted only in present times. Many great Islamic scholars of the past have stressed the importance of using gold as money. Examples include al-Ghazzali, ibn Taymiyyah, Qudama ibn Jaafar, Ibn Khaldun and al-Maqrizi⁶⁵. Also al-Asfahani in his book *al-Dhari'ah Ilá Makarim al-Shari'ah* indicated that only gold and silver could be used as money⁶⁶. Indeed, al-Maqrizi held that the change of the monetary standard from gold and silver to copper *fulūs* during the reign of Muhammad al-Kamil ibn Al-'Adil (615 – 35 H/1218 – 38 AD) in Egypt and Syria, were among the reasons for the ordeals that Egypt faced at that time, which included inflation and scarcity of necessities of life that brought about the disappearance of joy of life and ruination of wealth that reduced the people to privation, poverty and humiliation⁶⁷. The Holy Qur'an and the Sunnah of the Prophet s.a.w. also suggest gold as money. Consider the following verse for example.

*And there are those who hoard gold and silver and spend it not in the Way of Allah,
announce unto them a most grievous chastisement.
(Qur'an, At-Taubah, 9:34)*

⁶⁵ See Sanusi (2002).

⁶⁶ Mustafa Omar Mohammed (1998), p61.

⁶⁷ Ibid. pp.61-63.

It is clear that in the above verse Allah SWT is referring to gold and silver as money to be spent in His path. As for *Shari'ah* rulings, consider the following ahadith:

The Holy Prophet (peace be upon him) said: The system of weights and measures is the system of the people of Medina.

(Sahih Bukhari)

Yahya related to me from Malik from Humayd ibn Qays al-Makki that Mujahid said, "I was with 'Abdullah ibn 'Umar when an artisan came to him and said, 'Abu 'Abd ar-Rahman, I fashion gold and then sell what I have made for more than its weight. I take an amount equivalent to the work of my hand.' 'Abdullah forbade him to do that, so the artisan repeated the question to him, and 'Abdullah continued to forbid him until he came to the door of the mosque or to an animal that he intended to mount. Then 'Abdullah ibn 'Umar said, 'A dinar for dinar, and a dirham for dirham. There is no increase between them. This is the command of our Prophet to us and our advice to you.'"⁶⁸

It is interesting to note from the above hadith that even gold ornaments are to be exchanged weight for weight, which means that an artisan or jeweller is not allowed to add workmanship charges. The above tradition strengthens our contention that gold is to play the role of money and, therefore, discourages the fashioning of it into ornaments that would technically end up being 'hoarded' and not circulated in the economy. Also, the gold dinar and the silver dirham were, in fact, the units of measurement of the Medina System⁶⁹. Also, in *Shari'ah*, gold and silver are covered under *al-Sarf*, i.e. rulings that govern the exchange of money⁷⁰. Therefore, the Holy Qur'an, the traditions of the Prophet (s.a.w.), the history of Islam and the writings of Muslim scholars of the past, all do indeed point towards gold and silver as money in Islam. But somehow in the passage of time, Muslims seem to have lost the wisdom behind this, adopted fiat money and have subjected themselves to subjugation, poverty and humiliation as observed by al-Maqrizi in Egypt with *fulus* as money⁷¹.

Superiority of Gold over Other Forms of Money

Gold has intrinsic value just like any other commodity, but it distinguishes itself in that people of every race, creed and nationality desire it for its own sake as proven by the obsession humanity had for this metal throughout history. The following verse of Qur'an attests this:

Fair in the eyes of men is the love of things they covet: women and sons, heaped-up hoards of gold and silver ...

(Qur'an, Ali Imran, 3:14)

We summarize in Table 3 below, the characteristics that make gold as ideal money:

Table 3: Characteristics of Gold as an Ideal Money⁷²

	Characteristic	Remarks
1	Rare and Compact	Gold is rare; found and extracted only in minute quantities from earth. Being compact, a small amount of gold has big value. Therefore, one needs only small amounts for big purchases.
		The chemical property of gold is that it is an element

⁶⁸ Aisha Bewley (trans.) (1989). *Al-Muwatta*. p.256.

⁶⁹ See Farishta Zayas (2003), pp. 69-72.

⁷⁰ Tariqullah Khan (2004).

⁷¹ History repeating itself but on a much larger scale involving global Muslim world.

⁷² Source: Meera (2004).

2	Stable and durable for very long periods.	that rarely reacts with any other element or compound. It is so inactive that it is even extracted from the earth as gold itself (unlike iron, for example, that is obtained as iron oxide, which is then processed to extract the iron). Gold does not oxidize easily and, therefore, does not get rusty. Even gold treasures buried in the salty seawater for many centuries remain in their pure form. Gold is also not destroyed by extreme heat and pressure.
3	Homogenous and divisible into minute quantity	This characteristic is important since it allows the pricing of a whole range of values. It is homogenous in the sense that if a gold bar is cut into two halves, one need not choose between the two for they are simply equal. This splitting can go on until each unit is very small in weight. Gold is also homogenous in the sense that gold extracted from different parts of the world are practically substitutable for each other. ⁷³
4	Storable	Gold is an ideal store of value, i.e. something that can be saved for future use, even very far into the future. It is not uncommon for fiat money to become obsolete with the passage of time, but gold coins, on the contrary, had always maintained their intrinsic value.
5	Mobile	Gold can be moved between places easily and, therefore, can be used as money in different nations and places ⁷⁴ .
6	Can neither be created nor destroyed	If money can be created or destroyed (as fiat money is) then it is certainly a potential problem for the economy. Inflationary problems may crop up when it is created, while recessions and unemployment occur when it gets destroyed. When people use food items as money, for example, then when one consumes the food, money gets destroyed. But, gold as a metal cannot be created or destroyed and will be always there to play the role of money.

A major advantage of gold over fiat money is that it has intrinsic value and that it can neither be created nor destroyed. Its issuance or production is also not a monopoly of any single party⁷⁵, i.e. no unfair seigniorage. Gold is scattered throughout the earth and can be mined by anybody, unlike fiat money, the issuance of which is under the prerogative of some issuing bodies like the central banks and the commercial banks.

During a recession, fiat money gets destroyed through the reverse process of money creation. Money that is initially created in the form of accounting entries later gets destroyed in the same

⁷³ The different colour of gold sometimes observed is basically due to the other alloy metals added in order to strengthen it.

⁷⁴ A reason why gold price rises in times of uncertainties, war etc.

⁷⁵ Debasement etc. are of course attempts to benefit from seigniorage.

way. This destruction of money brings about a shrink in the money supply and a lower circulation of money in the economy which, in turn, causes lower demand and business transactions, lower business profits, bankruptcies, retrenchments, unemployment, etc.⁷⁶ With commodity money, particularly gold, however, such destruction is unlikely due to its physical nature. Therefore, gold as money can be expected to provide the much-desired stability missing in the current fiat money system. Unlike fiat money, gold needs not be introduced into the economy in the form of debt. It can, therefore, neither create capital structure problems nor require constant growth in money and economy for the mere sustainability of the system.

It is not surprising, therefore, that with the above characteristics (Table 3) gold naturally dominated as the global currency in history. No one had to force others to accept gold as money, unlike fiat money that had to be made a 'legal tender'.⁷⁷ By the time of the advent of Prophet Muhammad (peace be upon him), gold coins of the Roman Byzantine empire were already in circulation and were fully accepted by the Arabian community. The gold coins of the Muslim world were called 'dinar', deriving from the Latin *denarius*.⁷⁸ While the Prophet (peace be upon him) brought many changes to the social institutions of the time, the Roman denarius was, however, fully accepted as money in the new Islamic community. In that, is profound *Hikmah*. Indeed, the first Islamic *dinar*⁷⁹ was not minted until about fifty years after the demise of the Prophet (peace be upon him), by the caliph Abd al-Malik ibn Marwān in 75 Hijrah (696 CE). The caliphs were very concerned over the quality of the gold dinar and imposed severe punishments for crimes like coin clipping, etc. As the Islamic world expanded, these precautions along with the high moral standards of the Muslims of the past made the dinar the dominant and desired international currency, even replacing the Roman gold coin throughout Europe⁸⁰. The dinar remained the currency of the Muslim world for centuries until the fall of the Ottoman caliphate in the early 20th century⁸¹.

A commodity money like gold, therefore, is superior and desirable money compared to fiat money. It promises a just and stable monetary system while protecting the wealth (*al-mal*), sovereignty, culture and religion of the people. It also does not impose a 'hidden tax' on the people, which particularly affects the poor and the wage earners, as discussed in the Part I paper. All in all, commodity monies are, therefore, compatible with the *maqasid al-Shari'ah*.

Negative Interest Rates

We mentioned elsewhere earlier that negative interest rates discourages hoarding and instead encourages the circulation of money that has benefits for the economy. Many Muslim scholars have written on the issue of interest and *riba*. El-Diwan (1997), for example, argues excellently the inherent problems brought about by interest charges. Therein he argues that creation of money out of thin air by the banking system and the subsequent lending of it at interest to be an important

⁷⁶Realizing that it is the lack of money in circulation that is behind many socio-economic problems, particularly unemployment, some societies world-wide have resorted to their own community currencies to solve their problems. Lietaer (2001) and Greco (2001) discuss some of these successful community currencies.

⁷⁷ Since paper money and other fiat money have no intrinsic value, governments had to make their people accept them as money through legal means. This is what 'legal tender' is all about. The 'legal tender' status is precisely where a serious fault lies in the current monetary system. It denies the right of a community to decide on its medium of exchange.

⁷⁸ The word *dinar* refers to a standard weight of gold, i.e. 4.25 grams of a gold alloy that contains 91.6 per cent gold (also known as 916 gold or 22 Karat), just as the British sovereign that weighs 8 grams (also of 916 gold). *Dinar* does not refer not to the shape of the coin or the inscriptions on it.

⁷⁹ The Islamic dinar simply had the Roman inscriptions replaced with Qur'anic and Arabic verses instead.

⁸⁰ See Bernstein (2000), p.??

⁸¹ Which thereafter accelerated the degradation, backwardness and humiliation of Muslims to an unthinkable position relative to their glorious past in terms of knowledge, power and progress.

cause of economic injustice. Of course, the money creation process is made possible by the fractional reserve banking system. Lietaer (2001) argues that positive interest rates as being counter to sustainable development and that negative interest rates (eg. demurrage charges) are instead compatible with or necessary for sustainable use of resources and hence development. To quote him⁸²:

...interest rates create a built-in tendency to disregard the future ...the higher the interest rate, the more that tendency prevailswhich create a direct conflict between financial criteria and ecological sustainability under our present money system...

Lietaer argues that there is indeed a connection between currencies with demurrage charges and the remarkable prosperity during the First European Renaissance and the Pharaonic period in Egypt⁸³.

In the Islamic monetary system the negative interest rate function is, indeed, played by zakāt which 'taxes' the Muslim who has had in his possession a minimum zakātable wealth for one full year. Therefore, unlike in the present monetary system, unutilized savings are not only not rewarded in Islam but instead are 'taxed' and distributed away to the sections of the economy that need them most, i.e. the poor, orphans, those in debt etc. This section of the economy indeed has a high propensity to consume and would keep the aggregate demand high and the economic engine working. Since gold is a physical item that can neither be created out of thin air nor destroyed, it is, therefore, compatible with a 100 percent reserve requirement. Hence, it's obvious that the real money system of Islam with the institution of zakāt is diametrically opposite to the present monetary system of fiat money, fractional reserve banking and positive interest rates.

Some Common Queries and Objections to the Gold Dinar⁸⁴

The talk about returning to gold, of course, is likely to rekindle our memory on past experiences with gold and raise some questions. For example, if gold standard failed, why return to it again?⁸⁵ With gold standard, why did the Great Depression of the 1930's take place? To answer questions like these, one needs to analyze why a system that lasted for centuries failed? Chances are that the failure is not due to the system itself but rather due to the distortion of the existing system. Indications show, for example, that the cause of the Great Depression was, indeed, fiscal in nature, i.e. due to high tax rates of the Smoot-Hawley Tariff Act of 1930⁸⁶. Also governments printed more money than the gold reserves they had⁸⁷.

The possible volatility of gold price is another common objection. Gold price may fluctuate for many reasons. It may not necessarily be due to changes in the demand and supply of gold alone, but also could be due to changes in fiat money itself. For example, if a government prints too much of its currency, then the gold price in that currency will rise simply indicating the falling

⁸² Lietaer (2001), p.243.

⁸³ Ibid, footnote 271.

⁸⁴ In the course of arguing in favor of gold, the authors and other proponents of gold get queries and objections that are somewhat similar as summarized in this section. See for example, Meera (2002), El-Diwani (2002), Meera (2004) and materials on the web, e.g. <http://polynomics.com>

⁸⁵ Backing fiat currencies by gold as proposed by gold proponents is simply like returning to the gold standard of the past. See Mundell (1997), for example.

⁸⁶ Wanniski (1978), p.136.

⁸⁷ The US, for example, printed much more dollar notes than her gold reserves would permit, to finance the Vietnam war. This ultimately brought about the collapse of the Bretton Woods in 1971.

value of that fiat currency. Nevertheless, historically, gold has proven to be more stable than most currencies including the dollar, in terms of keeping its value.⁸⁸

Since the gold payment system is fundamentally a 'barter' system for every transaction involves mutual exchange of values, gold producing countries need not be necessarily placed at an advantageous position relative to non-gold producing countries⁸⁹. Having gold deposits is, therefore, not necessarily better than a fertile land that produces lush vegetation and fruits for example. The produce of land could then be exchanged for gold. Similarly, knowledge, skills and technological know-how are just as valuable as gold.

Some also argue that the global supply of gold is not sufficient to support the ever growing international trade. Also, since in most cases gold would only play the role as a unit of account, the same gold can be used again and again in many transactions. This is basically the velocity of money circulation. The higher the velocity, the lesser the amount of money needed to support a given amount of exchange⁹⁰. Meera and Larbani (2004) also showed that in international trade, a lot of transactions would cancel-out thereby requiring a much smaller amount of gold for settlement.

Some also query that new discoveries of gold may cause high inflation. Actually, it is fiat money that can be easily created or counterfeited and hence is more likely to cause inflation⁹¹. Gold production nonetheless entails technical know-how and heavy investment. Hence there are automatic checks on overproduction since miners know that overproduction would only invite inflation, i.e. why waste investment and effort that would only prove futile and translate into inflation?

Using gold for settling international trade balances would truly be a great step forward⁹². For Muslims, it would be a significant step that would complement the establishment of a true Islamic economics and financial system itself. The gold dinar promises a just and stable global monetary system while providing a stable international unit of account, which is lacking in the current global monetary system. It promises to check excessive currency speculation, manipulation and arbitrage while reducing transaction costs. Most importantly, it promises to protect countries from the threat of losing their national wealth and sovereignty to international financial powers through the interest-based fiat money system⁹³. In the current system, the Islamic bank is also caught up in the law-of-one-price that causes it to refer to the market interest rate in designing and pricing its financial products⁹⁴.

A gold payment system needs to be implemented in a gradual manner. One cannot and should not attempt to overturn the present system overnight. Therefore, a practical way to introduce a gold payment system is to begin with a dual system, i.e. the gold dinar co-existing with the national currencies. This is desirable considering the fact that not every individual may be convinced by the

⁸⁸ See for example, Jastram (1977).

⁸⁹ On the contrary, in the current system where the dollar is the dominant international currency, only the US benefits because it enjoys a monopoly over its issuance. However, no single country has a monopoly over the production of gold.

⁹⁰ This is easy to see from the equation of exchange $MV = PY$. For a given national output PY , the higher the velocity V , the smaller the money supply, M , is needed.

⁹¹ For example, Mundell (1997) regards the Federal Reserve as the greatest engine of inflation ever created and Milton Friedman's opinion that inflation is predominantly a monetary phenomenon.

⁹² Meera and Larbani (2004) discusses this in detail.

⁹³ See Part I paper.

⁹⁴ See Meera and Larbani (2004).

gold argument.⁹⁵ The best area to start is probably to implement the gold dinar for settling bilateral and multilateral trade arrangements⁹⁶, since this has the least implications for the existing national currencies. Concurrently, a small but parallel gold dinar economy should be established. This refers to a set of businesses that accept gold for payments in the domestic economy. This gold economy would form the nucleus for the implementation of a gold payment system domestically⁹⁷.

Conclusion

In this Part II paper we argued in favor of commodity monies, like the gold dinar for the elimination of the negative socioeconomic effects of fiat money. We argued that the gold dinar is compatible with the *maqasid al-Shari'ah* for it protects wealth (or *mal*), a *daruriyyah* component of the *maqasid*, while fiat money prevents the attainment of the *maqasid*. Further some common objections to the gold dinar were addressed. Finally, the initial steps for the implementation of the gold dinar were discussed. The paper asserts that commodity monies like the gold dinar, which is compatible with a 100 percent reserve requirement and the replacement of interest by *zakat* (technically a negative of interest rate) are characteristics of an Islamic money system; indispensable for solving the problems inherent in the present interest-based fiat money system and for the attainment of a true Islamic economics and finance system.

Therefore, we conclude that the Islamic economic system being fundamentally a 'barter' system, i.e. an exchange economy where goods and services are exchanged value for value solves the problems associated with barter by taking some of the commodities exchanged in the economy, that have the characteristics of money, as money. Commodity monies were argued as being compatible with the *maqasid al-Shari'ah* while fiat money as being counterproductive to the *maqasid*. The best of these commodities are, indeed, gold and silver.

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⁹⁵ Disagreement on this matter is, therefore, a blessing. Those who disagree need to be convinced by a working and successful implementation. Their gradual acceptance would also provide the gradual growth necessary for a smoother transition.

⁹⁶ Meera and Larbani (2004) discusses a non-linear mathematical programming technique of determining an efficient trade matrix among nations that would require the minimum amount of gold for settlement.

⁹⁷ See Meera (2004) for further discussion on the implementation of the gold dinar.

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DOES THE ISLAMIC FINANCIAL SYSTEM DESIGN MATTER?

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Abstract

This paper examines the empirical works on Islamic financial design. The design of the Islamic financial system encompasses primarily a myriad of institutional and market details, regulations and disclosure requirement. This will be a shift from the traditional view on the Islamic system activities which mainly focus on the regulations dictating the abolishment of interest rate in the financial system. Indeed to manifest the design of Islamic financial system, prudent and sound regulatory frameworks are also needed. Thus, this study answers to many unresolved questions. Among others are: Why do we suggest a different design for financial system? Or more importantly, does this design matter? What are the determinants of this design? How does this design affect the principal-agent relationship? In the Islamic financial system design, how do the financial institutions treat the agent? Does the design affect the corporate control? Does the regulation need to be amended?

JEL classification: G21; G28;

Keywords: financial design; bank regulation; legal requirement; Islamic banks; capital structure;

Introduction

Recently, there has been a rise of academic interest in the design of financial systems. Economists have centered their discussions on the theoretical insights into comparative advantage of bank-base or market-base systems in promoting long-run economic growth. Advocates of the bank-base systems emphasize the systems are better at mobilizing savings, identifying good investments and exerting sound corporate control, particularly during the early stages of economic development and in weak institutional environments (Stienherr and Huveneers 1994; and Titman and Wessels 1988). Others, however, emphasize the advantages of markets in allocating capital, providing risk management tools, and mitigating the problems associated with excessively powerful banks (Levine and Zervos, 1998 and Bartholdy et. al 1997). Reflecting these schisms, policymakers continue to struggle with the relative merits of bank-base versus market-base financial system in making policy decisions.

On the other hand, the Islamic financial design that has gaining ground is without exception. Nonetheless, the areas of research on this matter are very limited. It only focuses on the permissible scope of activities for Islamic banks and other Islamic depository financial intermediaries. These activities are mainly determined by the regulations dictating the abolishment of interest rate in the financial system (such as, Kurshid Ahmad (2000), Chapra (1985), and Siddiqi (1982))

These studies produce many unresolved questions. Among others are: Why do they suggest a different design for financial system? Or more importantly, does this design matter? What are the determinants of this design? How does this design affect the principal-agent relationship? In the Islamic financial system design, how do the financial institutions treat the agent? Does the design affect the corporate control? Does the regulation need to be amended?

Therefore, the design of the Islamic financial system should encompass primarily a myriad of institutional and market details, regulations and disclosure requirement. Indeed to manifest the design, prudent and sound regulatory frameworks are also needed. Hence, the regulatory framework for financial intermediaries should be tailored to achieve the different levels of economic development. How do these changes take place? Are these changes also aimed towards the changing roles of financial intermediaries and the emergence of new markets and products? Do the development of the legal and accounting standard have influenced on revolutionized roles of the financial intermediaries and market? And finally, how would all these changes affect the firm financing choices and capital structure?

The remainder of this paper is organized as follows. Section 2 presents the roles of the financial system to economic growth. It begins with the discussion on the financial institutions, in particular the commercial banks, which are originally viewed as a lender to the firms. Later, new intermediaries, such as the insurance companies, thrifts and formal capital markets are expanded to provide services to firms and individuals. Section 3 examines the roles of regulation, legal and accounting towards financial development. The reason for various reforms in regulations, legal and accounting standards are to ensure the efficiency of the financial system. Section 4 discusses the mechanism of the financial system. The mechanisms are discovered to play an important role in the financial decisions and activities which include screening, monitoring, allocating of capital, credit rationing and debt restructuring. Section 5 examines the issues surrounding the financial design. Section 6 explains the effect of the design on the firm choice of financing and firms' capital structure. It leads to the discussion on the ways the financial systems solve the issues related to asymmetric information and the corporate control contests. Section 7 concludes with thoughts about the potential further research on this matter.

Why Do We Need to Design the Financial System?

The earliest form of financial design begins its focus on the changing roles of the financial intermediaries towards economic development. Economists, among others, Schumpeter (1911)⁹⁸, Gurley and Shaw (1955), Tobin (1956), Goldsmith (1969), and McKinnon (1973) have long believed that financial intermediaries are important factors in supporting economic development. Schumpeter (1911) shows that the services provided by the financial intermediaries, such as mobilizing savings, evaluating projects, managing risk, monitoring managers and facilitating transactions are essential for technological innovation and economic development.

Later, Gurley and Shaw (1955) highlight the vitally important intermediary, which transmits funds by issues of indirect financial assets to surplus units (savers) and purchases of primary securities in deficits units (investors). In other words, the financial intermediaries play an important role in the credit's creation. Thus, the financial intermediaries affect economic development if investment funds are generated from direct finance or self finance and are not accessible from indirect finance offer.

Then, Tobin (1956) prolong Gurley and Shaw propagation by extending his "new view" which state that the essential role of financial intermediaries, especially commercial banks, is to satisfy simultaneously the portfolio preferences of the borrowers and as well as the lenders. Borrowers

⁹⁸ Were discussed in King and Levine (1993), pp. 717-727.

wish to expand their holding of real assets beyond the limit of their own net worth. Lenders, on the other hand, wish to hold part of all of their net worth in assets of stable money value with negligible risk of default. Therefore, financial intermediation is crucial to the economic development as it permits borrowers who wish to expand their investment in real assets to be accommodated at lower rates and easier terms than if they had to borrow directly from the lenders.

Commercial banks have commonly been the first financial intermediaries during the early stages of economic development. Later, new intermediaries, such as the insurance firms, thrifts and formal capital markets are expanded to provide services to particular classes of savers. These developments were empirically observed by Goldsmith (1969) through his study on thirty-six countries over the period of 1860-1961.

The importance of traditional and new intermediaries is tested empirically by King and Levine (1993c). They constructed four indicators, i.e., the ratio of liquid liabilities, deposit banks relative to the central bank in allocating domestic credit, the credit issued to non-financial private firms divided by total credit and credit issued to non-financial private firms divided by GDP. The empirical evidence was tested on 80 countries with data range up to 30 years. The result shows that there is a positive relationship between a range of indicators of financial development and economic growth. Thus, the level of financial intermediation is a good predictor of long-run rates of economic growth.

Recent studies by La Porta et al. (2000), Beck et al. (2000), King and Levine (2000 and 1993a,b,c) and Rousseau and Wachtel (1998) examine the relationship between financial intermediation and the different indicators of economic development. They use saving rates, capital accumulation and productivity growth as indicators of economic development. By testing the data of more than 60 countries, within 1965-1995, they prove that financial intermediary development and capital accumulation is less robust than the link between financial intermediary development and productivity growth.

Rousseau and Wachtel (1998) however, viewed the financial development differently. They found that a well organized equity, debt, and derivative markets may substitute the traditional role of financial intermediary as the financial system becomes more sophisticated. Therefore, they suggest that to search the causality relationship between the role financial intermediaries and economic performance should focus on historical periods when growing intermediaries dominate the financial sector. The intermediation intensity is measured by asset of commercial banks (CBA), the combined assets of commercial banks and savings institutions (BANKA), and composite that includes the assets of commercial banks, saving institutions, insurance companies, credit corporatives and pension funds (FIA). By using the data for five industrialized countries (i.e. United State, United Kingdom, Canada, Norway, and Sweden) over the period 1870-1929, they find that an increase in the intensity of intermediation has positive effect on level of output. The results support the notion that a rapidly growing financial system plays crucial role in allocating resource and improving the economic development.

The emergence of new financial instruments and the development of information technologies in the last three decades bring about the changes in the roles and development of financial intermediaries. Technology sophistication has substantially reduced the cost of information and minimized information asymmetry. At this juncture, Allen and Santomero (1998) and Holmstorm and Tirole (2000) exert that, the issues surrounding the role of the intermediaries, such as transaction costs and asymmetric information, are less relevant in explaining the development of the intermediaries but, new roles of intermediaries, that consist of risk trading and participation

costs, are much crucial.⁹⁹ They argued that risk management has become a key role area of intermediary activity, because they facilitate the risks transfer and they deal with varieties of financial instruments and markets and thus putting the central concept of participation costs. The sophistication and the development of the financial market have minimized the transaction costs due to the efficient and cheaper information transmission.¹⁰⁰

How Does the Islamic Financial System be Designed?

Financial economists have classified the financial system to be a bank based and a market base design. The market-based system emphasizes the importance of financial markets. Firms obtain external financing either from bank borrowing, from issuing bond or from issuing new shares (equity financing). While in the bank-base design focus would be on the extensive role of the bank. The bank not only provide loan and at the same time holding the equity stake of the firm and be in the main board of directors.

Whether funds are to be derived from the market or bank, the design of Islamic financial system as compared to its conventional counterparts, the bank-base or market-base design, has two major distinctions. First it will devise the profit and loss sharing (PLS) mechanism and second the mark-up financing. PLS is formed from mudarabah funds (investible funds) and musyarakah funds (equity funds). Murabahah (mark-up financing) and Ijarah (capital leasing financing) are loanable funds with Islamic features. The conventional bank loans operate under the credit system, whereby interests are compounded and subject to fluctuation. On contrary, the Islamic financing, murabahah or ijarah, the concept of profit is in place of interest and agreeable by the borrowers as mark-up financing.

Some of the economic rationales for the superiority of profit-loss-sharing over the use of interest, quoted by Aggrawal and Yousef (2000), are described by International Association of Islamic Banks (1995, pp. 3-4):¹⁰¹ If interest is replaced by profit sharing, some imbalances are expected to be reduced. First, the return on capital will depend on productivity Allocation of investable funds will be guided by the soundness of the project. This will in effect improve the efficiency of capital allocation.

Second, the creation of money by expanding credit will be created only when there is strong likelihood of corresponding increase in the supply of goods and services. In case the enterprise loses, repayment of capital to the bank is diminished by the amount of loss. Thus, in the profit sharing system, the supply of money is not allowed to overstep the supply of goods and services. This will eventually curb inflationary pressures in the economy.

Third, the shift to profit sharing may increase the volume of investments that translates into job creation. This is because the interest mechanism makes feasible only those projects whose expected profit is sufficiently high to cover the interest rate plus added income. This filters out projects which otherwise would be accepted in the profit-sharing system.

Fourth, the new system will also ensure more equitable distribution of wealth. Wealth would bring more wealth to its owners only when its use has actually resulted in the creation of additional

⁹⁹ Scoter and van Wiston (2000) argue that the risk management is not the only factor determines the role of financial intermediaries and persistent that the transaction cost and asymmetric information are still relevant in the financial intermediaries, even though technology information is available.

¹⁰⁰ The technological revolution and enhancement has substantially reduced the cost of information and reduced information asymmetry.

¹⁰¹ See Aggrawal and Yousef (2000) for the critical views towards these assertions.

wealth. This would in time reduce the unjust distribution of wealth, which continued for decades during the interest regime.

Fifth, the abolition of interest, together with the restriction of forward transaction, as prescribed by Sharia, will curtail speculation measurably. But still, there will be secondary market trading common stocks and investment certificates based on profit sharing principles. This will bring sanity back to the market and allow rising of funds for enterprises and liquidity to equity holders.

Principal-Agent Relationship

The Islamic financial system design produces two important types of financing, i.e debt (murabahah) and equity (mudarabah) financing. These financings might produce a new relationship between principal and agent. In the following discussion, we will identify six forms of relationship: i.e. screening and monitoring entrepreneurs, credit rationing by banks, allocation of capital, liquidity creation and management of liquidity risk, monitoring managers and exerting corporate control and debt restructuring.

Screening and monitoring potential entrepreneurs

Islamic financing can be in the form of murabahah (mark-up based scheme) financing or mudarabah financing (Profit loss sharing). The mark-up based scheme has a similar feature as debt contract and involves the similar screening and monitoring process. Nevertheless, it has several differences that make it uniquely Islamic: (i) It is commodity based financing, (ii) No Penalty interest for past-due, (iii) No compounding interest rate for the past due obligations, (iv) no floating interest rate during the whole period of the contract, (v) in case of bankruptcy, only the initial debt (including the mark-up) is recovered.¹⁰² Thus this lead mark-up based scheme has similar features as 'standard debt contract' that it has the advantage of being optimal contract.

In the mudarabah financing, banks funded totally the project or in the form partnership with the entrepreneur on the Profit and Loss Sharing basis (PLS). Islamic bank may require the entrepreneur to maintain minimum holding of certain assets relative to the business size, thus keeping its net worth high. When an entrepreneur has a higher stake of his net worth, his incentives to be dishonest will be significantly dropped because he has a lot to lose.¹⁰³ By screening and monitoring, entrepreneur aware that his utility depends on the utility of the borrower and corporation is the best solution. Besides that, borrower knows that he has being monitored and the lender can predict what action to be taken by the borrower. Thus, the entrepreneur will optimize his decision and this enhances the level of investment.

Credit rationing by banks

Banks may ration borrower in the presence of Basle accord capital requirement and asymmetric market. In the asymmetric market, credit rationing occurs when banks quote mark-up rate on loans and supply a smaller loan size than demanded by the borrowers. Stronger form of credit rationing and screening may occur the banks prefer to evaluate the firm's project quality and project choice. Hence, credit rationing can also be in the form of denying credit to some firms entirely. While the asymmetric information concerns the choice project base on its riskiness (safe or risky).

Alternatively, the combination of both the trustworthiness of the entrepreneur and the viability and usefulness of the project (i.e. towards the physical expansion of production and services) may

¹⁰² Constraint (ii) and (iii) are applied in case of the customer is unable to pay.

¹⁰³ This view is consistent with findings by Ross (1977) in asymmetric information model and Harris and Raviv (1990) in agency model.

encourage large and small entrepreneur to venture into business with greater possibility of getting financing from the Islamic banking.

Allocation of capital

Financial intermediaries can minimize the cost of acquiring and processing information about investment, which are costly to be done by individual savers. Eventually, savings channeled through financial intermediaries are managed more efficiently. King and Levine (1993c) state that the ability to acquire and process information leads to higher economic growth because intermediaries capable of allocating funds to the most promising firm. In addition, financial intermediation can stimulate the rate of technological innovation by providing funds to entrepreneurs with the best chances of successfully initiating new goods and production processes. Here, the specialty of the financial intermediaries is to manage the deposit and at the same time allocate capital to entrepreneurs.¹⁰⁴ However, the role of financial intermediaries as monitors and information specialists, therefore financial intermediaries tends to provide debt.

If the allocation of capital is done based on the sharing of risk and profit, and then, the actual performance of the project, enterprise or the economy as a whole determine the return on capital.¹⁰⁵ Therefore, in this profit sharing technique, which make the capital share profit according to its actually realized productivity. According to Khan (1995) the actually realized return on profit is thus the price of capital, which will determine its allocation.

Liquidity Creation and Management of Liquidity Risk

Banks create liquidity by issuing liquid deposit claims against illiquid loans, and this to Thakor (1996) is known as qualitative asset transformation (QAT)). Nevertheless, uncertainties, known as credit risk, may occur in converting assets into medium of exchange. The situation worsens due to transaction cost and information asymmetries, which slow down liquidity and intensify the liquidity risk. However, financial intermediaries enable investors to share these risks. The link between liquidity and economic development arises because some productive projects require a long-run commitment of capital. However, according to Bencivenga and Smith (1991), savers do not like to relinquish control of their savings for long periods. Thus, liquidity affects production decision. With the financial markets, savers can hold financial assets; equity, bonds, or demand deposit, that they can turn to cash or medium of exchange quickly and easily. At the same time, the market transforms those liquid financial instruments into long-term capital investment in illiquid production processes. In other words, with liquid stock markets, saver shareholders can sell their assets, while firms have permanent access to the capital invested by the initial shareholders.

The model by Diamond and Dybvig (1983) shows the superiority of risk sharing provided by the bank. By offering liquid deposits to savers and choosing an appropriate mixture of liquid and illiquid investments, banks provide complete insurance to savers against liquidity risk while simultaneously facilitating long-run investments in high-return projects. Therefore, savers or shareholders can liquidate their asset while firms' capitals are sustained and not jeopardized. Nevertheless, Kahane (1977) believes that capital requirement cannot deter the bank risk taking and may even intensify the problem; assert Besanko and Kanatas (1994).

¹⁰⁴ The words banks, financial institutions, and financial intermediaries are used interchangeably.

¹⁰⁵ Elsewhere it is mentioned as Profit Loss Sharing. Return base on real performance of the project, i.e. *ex-post facto* and not a pre-determined form for one party, an *ex-ante* assured return.

Monitoring managers and exerting corporate control¹⁰⁶

Outside creditors to the firm or outside investors do not manage firms on day-to-day basis because it is too costly for outsider investors to verify project returns and have to rely to the financial intermediaries. Financial intermediaries may arise to alleviate the information acquisition and enforcement costs of monitoring firm managers and exerting corporate control. Thus, this may deter insiders to misrepresent project returns to outsiders. Furthermore, in the case that borrowers need to obtain funds from many outsiders, financial intermediaries can economize monitoring costs.

According to Diamond (1984), financial intermediaries reduce information and incentive problems by monitoring the borrower. Some monitoring takes place before a contract is signed and some takes place after the contract is signed. The former serves to reduce the proportion of bad loans and serves to improve the performance of a given contract. Therefore, monitoring is much effective to be delegated to the financial intermediaries. Bernanke and Gertler (1989 and 1990) conclude that the reduction in monitoring cost can foster efficient and long run investment.

Diamond (1991a) develops a model in which borrowers can choose between a bank and the financial market. In Diamond's model, some borrowers can substitute risky assets for safe one at lender's disadvantage. Bank, however, resolve the asset-substitution moral hazard problem through monitoring. Nevertheless, incentive in the form of lower interest rate and high credit rating, was given for borrowers who can repays its loan in any given period of time in the choice of safe project n that period. Thus, borrowers with better credit reputation will perceive a high present value of its net payoffs from future bank loans. On the other hand, borrower who defaults at any time is then forever excluded from the capital market or bank borrowing. Therefore, borrower with a good reputation will attach a lower value to choosing the risky project over the save one hence has reached the reputation cutoff between safe and risky project and thus bank monitoring is unnecessary. Diamond's model further indicates that borrower with promising credit reputation will approach bank and more mature borrowers with well-established credit reputation access the capital market directly.

In the case of Islamic banking, monitoring is essential in almost all form of financing because asymmetric information and moral hazard are not exception. Habib Ahmed (2000) claims that depositor's preferences for using an Islamic bank may be due to religious or ethical reasons, while the investors of these banks do not necessarily have this motive.¹⁰⁷ Nevertheless, financing under *musharakah*, the capital owner has a right to enter into the management and hence have some control over the problems created by the informational asymmetry and moral hazards. *Musyarakah* financing is expected to ease the monitoring activities.

Debt Restructuring

Debt restructuring will be one of the crucial roles of the financial system to ensure economy will not easily succumb by the financially distressed firms. Firms react by restructuring their assets or liabilities. According to Asquith et al (1997), firms in financial distress tend to make several

¹⁰⁶ The monitoring activities will be upon the insiders (managers and key personnel) who access to inside information. Monitoring can hinder insider trading that could affect the firm value. Monitoring could also deter misrepresentation by the insiders to potential investors. While monitoring in section 4(a) refers to monitoring the project or firms

¹⁰⁷ This is also reflected in the fixed-income *murabahah* contracts. To deal with the slackness and dishonesty of the clients in *mudarahah* contracts, a fine is imposed by Islamic bank in case of arrears in repayment arise (Usmani (1998)).

options such as debt restructuring, sale of assets, merger and capital expenditure reduction.¹⁰⁸ However, firms with fewer tangible assets or less liquid assets, and lower capital prefer to use the debt restructuring.

Bank usually likes to renegotiate the debt if in the case of default when the cost of bankruptcy is larger than liquidation of entrepreneur's asset. This is done by either loosening or tightening the debt contract. The "loosening" of debt contract may take in different forms such as deferring the principal and interest payment, providing new financing, and waiving covenants. While the "tightening" of debt contract may also take in different forms such as accelerating the principal and interest payment, reducing lines of credit, and increasing collateral. The banks are more prone to loosen the terms of contract when they hold secured position and tighten when they hold unsecured position.

Sabani (1992) develops a model in which banks accumulate borrower specific proprietary information in the post lending stage of the relationship. Such information provides incentives for the incumbent bank to protect the relationship by restructuring the debts of its financially distressed borrower. Berlin and Master (1992) assert that banks will tend to negotiate loan contract that have stringent covenants but will be willing to negotiate these covenants if warranted. Thus, one of the benefits of bank loan that was identified is on the ability of the loan to be restructured and thus interim-efficient outcome can be maintained and this ability is not available in the capital market. Berlin and Master (1992) indicate that firms likely to receive significant post lending information prefer banks due to their relative advantage in restructuring ex post inefficient contract. Groton and Khan (1993) remind that the effect of risk taking has to be considered while renegotiating the loan. Thakor and Wilson (1995), on the other hand, focus on the possibility of tension between the benefit of bank financing on the one hand and the higher cost of bank financing due to bank capital requirement on the other. Since an increase in the capital requirement, after the loan has been restructured, has caused the competitive loan interest rate rises. Nevertheless, if bank refuse to restructure the loan, it will reduce the bank's uniqueness in the credit reallocation. Both scenarios have similar effects and making capital market relatively more attractive.

Firms can also make debt restructuring through an exchange offer. It means that firms offer a package of cash and securities in exchange for some or all of its outstanding debt. However, this package cannot reduce the principles amount of public debt without the approval from shareholders, except through an agreement with debt-holders or tender offer that exchange the old debt for new securities.

Islamic banking offers *qadr hassan* financing in case of needs. Being in financial distress is one of the reasons for *qadr hassan*. The burden of cost of financing as discussed by Thakor and Wilson (1995) will eventually overcome. Nevertheless, *mudharabah* and *musyarakah* financing leave entrepreneur with little possibilities to be in financial distress. This is made possible because the firm has less debt and can further resort to equity financing or can borrow from bank in the event of financial distress.

Islamic Financial Design and the Firm Capital Structure

There are two important questions on how we could relate capital structure and financial design. How does a firm decide which source of financing to use at any given time? Can the financial institutions determine the firm's capital structure? The former question was partly answered by

¹⁰⁸ The firms in financial distress in any two consecutive years, the firms profit before interest, taxes, depreciation, and amortization is less than interest expense (EBITDA) defined and if in any one year, EBITDA is less than 80 percent of its interest expense.

ground. These various changes were the result of the diverse financial design that evolves in the economic system.

Future research should incline their interest on the efficiency and effectiveness of the systems. The question on the rules, regulation and accounting standards should persist on any of the study. Researcher should raise their concerns on what are the rules and regulations and the laws that should persist or reform if the designs to be effective, to co-exist or to be dynamic. The Islamic systems, which are seen to be the best alternative, have lack of complete legal and accounting system that to make it highly recognized. Thus scholars in these areas should delve in this matter.

No discussion on the financial design, as mention by Thakor (1996) will complete without a discussion on political environments and political economy of design. The types of ideologies that affect the operations of the system, the political inclinations and the ruling party agenda are some of the interesting issues that have been little analysis. Future analysis will then become complex and more challenging.

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Business Session : 4

20th December 2004, Monday, 9.00 A.M.~11.00 A.M.

HARMONIZING FINANCIAL INSTRUMENTS BY SOCIAL NETWORKING

KEYNOTE LECTURE

Professor Dr. Sofyan Syafri

Faculty of Economics & Management

Director of the Postgraduate Program in Islamic Economics and Finance (PPIEF)

Trisakti University Jakarta, Indonesia.

On the experience of Islamic banking in Indonesia

Dr. Abul Hassan

Markfield Dawa Center

The Islamic Foundation Leicester, England.

Networking: Islamic social capital, development and the role of formal and informal institutions

Dr. Muhammad Nurul Alam

Assistant Professor of Accounting Sultan Qaboos University

The influences of 'Societal Sector Institutions' in promoting lender-borrower network relationships between Islamic Banks and small and cottage industry owners (A study based on the Islamic Banking Finance to rural-based small and cottage industries in Bangladesh)

and the author, 1994, London: Sage, pp. 116-124.

THE IMPACT OF MARKET EXPERIENCE ON SHORT-TERM DECISIONS

by *John G. S. Hillier, University of Cambridge, and Robert W. Hodgson, University of York*

ABSTRACT

Product, market and industry

Product, market and industry experience

Impact of experience on short-term decisions

Product, market and industry

Product, market and industry experience

As the product, market and industry experience

of the decision maker increases, the impact of

experience on short-term decisions

increases, and the impact of

experience on short-term decisions

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As the product, market and industry

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ISLAMIC SOCIAL CAPITAL AND NETWORKING

*Abul Hassan*¹⁰⁹

Abstract

The concept of "Islamic social capital" is useful when interpreted as the networking between sets of agents located in different sectors of the economy. Networking creates the ground rules for the transparent functioning of development interventions as well as developing trust and co-ordinating action. It also promotes innovative interactions between agents and helps to solve problems such as free-riding and bottleneck of networking which typically prevent communities from conserving and harnessing their natural capital.

This paper illustrates the role and interpretation of Islamic social capital is formalised drawing a case study in a predominately Muslim area in India. This intervention had as its major concern a linking of development with livelihoods emerging from protection and sustainable management of the natural resource base of the area. It shows how innovative networking and strengthening of informal institution through the inputs of technology, financial and human capital constitutes an essential input in operationalising the concept of 'sustainable development' in such context.

1.Introduction

The Muslim world is still a long way from an integrated global Islamic governance with global Islamic institutions. In the absence of that governance and institutions, however, networks can play a vital part because they are an organisational form with an extraordinary capacity for innovation, managing risk, building trust, facilitating joint action and gathering information in a manner that flows around and between geographical, legal and institutional barriers. Consequently, networking is doing much to make up for the absence of integration and may be considered as a part of the *shuratic* process and *ummatic* desire working for the all round development of an Islamic society.

1.1 Definition of Social Capital

Brehm and Rahn (1997) define social capital as: "the web of cooperative relationships between citizens that facilitates resolution of collection action problems". Hite (2000) divides the notion of personal relationships into three distinct types based on varying degrees of emotional proximity and involvement within networks. Kloosterman et al (1999) describe the combination of social and professional networks primarily for economic benefit as "mixed embeddedness" and attribute this interaction predominantly to communities. They argue that embedded networks of individuals are not limited to one group but incorporate resources available throughout the wider community.

The term "Social Capital" initially appeared in the community studies highlighting the central importance – for survival and functioning of city neighbourhoods – of the networks of strong, crosscutting personal relationships developed over time that provide the basis for trust, cooperation and collective action in communities (Jacobs, 1965). Early usage also indicated the significance of social capital for the individual e.g., the set of resources inherent in family relationships and in community social organisations useful for the development of the young child (Loury, 1987). The

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Sunnah are studied in relation to real world issues affecting the unit or enterprise. Thereby, the analytical study and understanding of the principle of pervasive complementary among knowledge-induced possibilities in real world situations are used to convey the concept of unification and participation. An area to be examined would be a feasibility study on product diversification for basic needs that can be dynamically improved to higher vintages of goods. In this way focus is placed on the real sectoral interlinkages that can be generated through grass-roots activity and such linkages between money and real productive outlets.”

In the present world the society is lacking Islamic values. In the traditional type of society, the norms and rules determined informally at local or micro levels may turn out to be in conflict with formal Islamic financial institutions, development agency or legal institutions. So, there is need to make expansion of development to encompass large spatial or higher well-being levels, a dynamic Islamic motivational process (*Islah* in order to achieve the *makasid-e-shariah*) needs to be set in motion requiring an extended networking to create consistency with the macro-level initiations. This implies that an evolving and increasing stock of “Islamic social capital” is a necessary input into a sustained process of development.

The possible meaning of “Islamic social capital” may be to achieve the well-being, which is a part of the Islamic social welfare system. In other words, Islamic social capital is the networking that helps to create the linkages, which in turn motivate people to follow up the Islamic conventions and norms governing the development process. Therefore the concept of “Islamic social capital” has added a new dimension to the dialogue on development from an Islamic perspective. While institutions have long been considered as significant in development theory, viewing the density of formal and informal institutions for development as “Islamic social capital” formalises the link with labour and capital as inputs into development.

This paper addresses the question of the relevance of the concept of “Islamic social capital” to development processes. It argues that Islamic social capital is best conceptualised as an input into the process by which institutions for development are created. As an index of the density of interaction amongst agents (viz. between Islamic financial institution and development agency) of development located in different formal sectors of an economy, it will determine the sustainability or otherwise of processes aimed at achieving ‘development’ at local decentralised levels. The Islamic principles, norms and values emerging out of those processes together with complementary inputs such as Islamic financial capital and human labour will then determine the nature of the ensuing development process. In this paper, the role and interpretation of Islamic social capital is formalised drawing on in-depth study of developmental interventions in a Muslim majority region in the West Bengal province in India. These interventions have as their major concern a linking of development with livelihoods emerging from protection and sustainable management of the natural resource base of the region. It is argued that the strengthening of informal institutions through the inputs of technology, financial and human capital from across different sectors constitutes an essential input in operationalising the concept of “sustainable development” in such contexts. When the focus of the development intervention is on livelihoods and Islamic welfare accrual from common or *waqf* property resources, drawing on informal networks minimises problems relating to free riding and high discount rates emerging out of a myopic view.

Also investigated is the limits to replication of micro experiments and their scaling up arising typically due to lack of linkage between these local level informal institutional networks and formalised legal developmental and market dominated institutions.

1.3. Layout of the Paper

In section 2 we discuss organisations as institutional settings conducive to the development of Islamic social capital. Section 3 focuses on Islamic social capital as networking leading to development. Section 4 discusses sustainable development for well-being. Section 5 focuses on Islamic social capital and village community development and examines the determinants of processes of institutional change as determined by availability of Islamic social capital in the context of one in-depth case study in West Bengal, India. Section 6 draws conclusions.

2. Organisations as Institutional Settings Are Conducive to the Development of Islamic Social Capital

Business networks of Islamic bank or any financial institutions need to develop communication networks in order to build the Islamic social capital to generate mutually beneficial relationship satisfying combination of business and social needs. It is important to note that Islamic socio-economic system includes detailed coverage of specific economic variables such as estimation of profit and loss sharing, taxation, circulation of wealth, fair-trading, and consumption. Islamic law derived from the Shari'ah also covers business relationships between banker and customer or lender and borrower. Max Weber (1988) delineated "economics ethics" as "...not the ethical theory of theological compendia... but the practical impulses for action and are based on the psychological and pragmatic connection of the religion" (page. 238). Ghaussy (1986), Nienhaus (2003) and Lewis (2002) have observed that the economic ethics of the Qura'n would be compatible with a social market economy.

In his in-depth study in respect of socio-economic development within the Islamic political economy, as an interlined and creative system of interaction and integration, Choudhury (2003) developed an overlapping generation valuation model in order to evaluate social well-being. Choudhury (2003) provides insight into the co-evolution of knowledge and relationship for the cause of Ummatic transformation, which he considers the equivalent of globalisation but in an Islamic sense. Specifically he describes four variables:– participatory political economy; appropriate technological change; Islamic financial instruments of economic participation through cooperation; and mobilisation of physical, human and technological resource by development financial instruments. Choudhury (2003) desires the technology engagement in the ongoing creation and negotiation of shared understanding and consultation (*shura*)- an understanding towards collective knowledge, which in turn will contribute in the development process. Further the form of social construction, which according to Choudhury (2003) is also important but less evident, is the creation a shared identity. This suggests both a view of knowledge as object and of knowing as action or enactment in which progress is made through active engagement with the world on the basis of Islamic approach to knowing. The collective mind located in processes of interrelating through *Shura* (Choudhury, 2003) highlights the mutually dependent and interactive ways in which social and intellectual capital co-evolve. In view of this, it may not be out of place to emphasise that the co-evolution of social and intellectual capital provides a dynamic perspective on the development of the organisational advantages of Islamic financial institutions.

Therefore, Islamic social capital developed in one context, such as ties, norms and trust based on universal Islamic principles are transferred from conventional social settings to Islamic social settings, which will influence pattern of social exchange. Examples include the transfer of trust from family and religious affiliations into work situations (Fukuyama;1995), the development of personal relationships into business exchanges (Coleman, 1990) and the aggregation of the social capital to of individuals into that of organisations (Burt, 1992). Therefore, appropriate Islamic organisations (such as Islamic banks) can provide a potential network of access to people and their

resource, including information and knowledge and through its relational and cognitive dimensions, may ensure motivation and capability for exchange and combination between Islamic bank and Islamic social capital groups. However, such organisation also may inhibit such processes; indeed, research demonstrates how organisational routines may separate rather than coordinate groups within organisations, constraining rather than enabling learning and the creation of intellectual capital.

Community people and other agents, such as Islamic bank and social groups, NGOs, to a relationship rights for individuals, may jointly own Islamic social capital. Thus, it will be fundamentally concerned with resources located within structures and processes of social exchange. As such the development of Islamic social capital will be significantly affected by those factors shaping the evolution of social relationships. We will discuss four such conditions here: time, interaction, interdependence, and closure.

(1) Time and Development of Islamic Social Capital

Like other forms of capital, Islamic social capital constitutes a form of accumulated history, which reflects investments by the Islamic financial institutions in social relations and social organisation through time. Time is important for the development of Islamic social capital, since all forms of Islamic social capital will depend on stability and continuity of the Islamic social structure. The concept of embedding fundamentally means the binding of social relations in contexts of time and space. For example, since it will take time to build trust, relationship stability and durability will be the key network features associated with high levels of trust and norms of cooperation based on Islam. The duration and stability of social relations also influence the clarity and visibility of mutual obligations.

Islamic social capital may owned jointly by the community people and Islamic financial institutions based on universal Islamic brotherhood principles, with no exclusive ownership rights for individuals. Thus it is fundamentally concerned with resources located within structures and processes of social exchange. In contrast to the short-term transactions characterising the markets of neoclassical theory, intentional or constructed organisation will represent the creation and maintenance of an explicit and enduring structure of ties constituting, through organisational design, a configuration of relationships and resources usable for a variety of purposes – both formal and informal. Moreover, this commitment to continuity will facilitate the other processes known to be influential in the development of Islamic social capital: interdependence, interaction and closure among the Islamic bank, development organisations, NGOs and social groups.

(2) Interdependence and the Development of Islamic Social Capital

Islamic social capital may be eroded by factors that will make people less dependent upon each other. This may appear especially in the relational dimension of Islamic social capital. For example, expectations and obligations may be less significant where people have alternative sources of support. Misztal (1996) has suggested that the increasingly transitional character of our present condition and the erosion of social interdependence and solidarity can explain the recent resurgence of interest in trust. Yet Chapra (1992) agrees that high levels of Islamic social capital (social entrepreneurs) usually may be developed in contexts characterised by high levels of mutual interdependence. Whereas markets as institutional arrangements are rooted in the concept of autonomy, Islamic financial institutions fundamentally are institutions designed around the concepts and practise of specialisation and interdependence and differentiation and integration. Interdependence (between shareholder, customers and Islamic bank) and the coordination it implies has long has been recognised as perhaps the key attribute of business organisation. Such

interdependence provides the stimulation for developing many organisationally embedded forms of Islamic social capital.

(3) Interaction and Development of Islamic Social Capital

In neoclassical theory, markets as institutional settings are epitomised by impersonal, arms-length, spot transactions. In contrast, Islamic financial institutions provide many opportunities for sustained interaction, conversations, and sociability by design. Formal Islamic banks are explicitly designed to bring shareholders/customers together in order to undertake their primary task, to provide intermediary services, and to coordinate their activities, particularly in contexts relating to the two main modes of financing – Mudaraba and Musharaka, requiring mutual understanding. Together, these can be viewed as collective investment strategies for the institutional creation and maintenance of dense networks of social relations and for the resources embedded within, available through, and derived from such networks of relationships.

(4) Closure and the Development of Islamic Social Capital

There is much evidence that closure is a feature of social relationships that is conducive to the development of high levels of relational and cognitive social capital. The development of norms, identity and trust are facilitated by network closure (Ibarra, 1992) and the development of unique codes and language is assisted by the existence of community separation (Boland & Tenkasi, 1995). Islamic financial institutions, by definition, imply a measure of closure through the creation of explicit legal, financial and social boundaries. Conventional markets in contrast, represent open networks that benefit from the freedom offered to individual agents but have less access to the relational and cognitive facets of social capital.

3. Islamic Social Capital as Networking Leading to Development

The role of Islamic social capital may be defined as the networks and relationship that both encourage trust and reciprocity and shape the quality and quantity of an Islamic society's social interactions in providing the inputs and growth. The nature and role of Islamic social capital may be elucidated better by asking questions such as:–

- How does Islamic social capital contribute to development processes?
- How is this contribution different from the manner in which other kinds of capital such as physical or human contribute?

We will postulate the essence of the contribution of Islamic social capital to development processes is in the initiation of a process that enables a “reaching out” between Islamic financial institutions and developmental agencies as the basic starting point for successful development interventions. This will help to deal with problems of different kinds and initiates a development process. In one instance, such a reaching out between the Islamic financial institution and development organisations may overcome a “trust problem”. Defining the process of development through the perception of the agents with a stake in it may do this. Rules, norms and institutional structures are then set up and requirements in terms of financial capital follow. We may say that the informal institutions are in place through this reaching out across formal sectors and comprise the contribution of “Islamic social capital.” The process of building up Islamic social capital at decentralised levels will finally lead to issues of political and legal reform. However, it is important to recognise that the concepts of ‘bridging’ and ‘linking’ Islamic social capital do play a role in clarifying the process by which informal institutions come into being and initiate development processes.

Individuals who belong to different formal organisations base development process typically on a co-production. Co-production implies that there exist complementarities between the role of agents

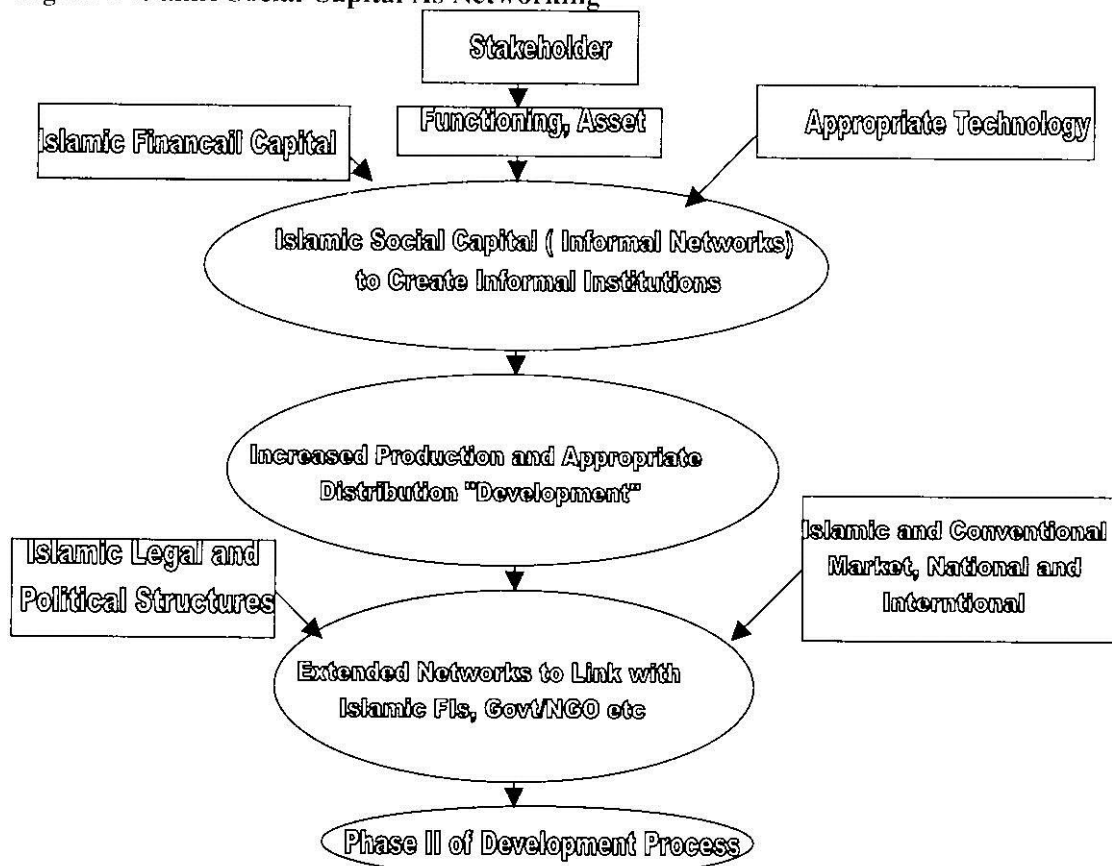
such as Islamic financial institutions who are also implementing the development schemes of the government and those who belong to non-governmental organisations or even user groups. In conventional sector a number of instances of success of such co-production are available.

Examples are the provision of health service in Brazil, the conservation of biodiversity (Salafsky and Wollenberg, 2000) and eco-system conservation in Africa (Western 1994), woman empowerment and income generating activities by Grameen Bank, Bangladesh (Meyer, 2002). There are example of success of co-production through Islamic micro-finance implemented by the Islamic bank Bangladesh and self-help groups, Bila-Sudi Qardh-schemes organised by the some religious organisations such as Jamaat-E-Islamic Hind, Islamic Fund Nazibabad, and Islamic Qardh schemes of Darul Uloom Deoband et al in India, which made considerable success in respect of development process in the field of Islamic social capital building. These are all instances of success of development initiatives as a consequence of a series of interactions between persons placed in different Islamic formal sector such as Islamic NGOs, Islamic financial Institutions (in case of Bangladesh) and Islamic socio-economic organisations. They came together to solve a perceived problem and the nature and intensity of their interaction made possible the solution.

It is seen that the situation on the rural or base level is often complex, with agents within each sector providing the initial impetus as they emerge during the process of change. Social entrepreneurs in other words, can exist in any sector and their reaching out across Islamic financial sector is essential. The emergence of such social entrepreneurs is the consequence of the existence of Islamic banking sector with linkages across agents in different from sectors. Development requires its strengthening and augmentation.

Displayed in figure 1 below is a schematic picture representing the role of such reaching out at critical stages in the process leading towards sustainable development. The social entrepreneur who perceives the problem of backwardness brings them together to formulate a set of values and norms in the light of the Al-Quran and Sunnah of the Prophet (peace be upon him) in the proposed process. At this stage, it is important to secure ownership of the process and to have a comprehensive coverage of all stakeholders. Once this is done, the availability of complementary inputs such as financial and human capital on Mudaraba or Musharak basis ensures the initiation of development.

Figure 1 Islamic Social Capital As Networking



In respect of Islamic social capital as Networking in cooperative efforts, the process will gain momentum and spread both spatially and temporally. Its sustainability may be questioned on account of the scarcity of any one kind of input. Complementary inputs such as Islamic financial capital are then called for. When the legal and political process will be introduced then existing conventional norms and rules, which were in the governing process in society will create conflict with macro Islamic legal or political process. The movement to a new stage of development is then only possible if a new reaching-out across sectors is made possible through the intervention of a social 'entrepreneur' which will be patronised by the Islamic financial institutions (IFIs). In the next macro scale of development, the need may be for intervention that impacts on Islamic legal and or Islamic political economic structures. It is only such intervention, which will ensure the embeddedness of the development process. We may say in the other words that the distinctive feature of "Islamic social capital" as an input into development is that it ensures qualitative changes in procedures governing the development process to ensure its embeddedness and linkage or coordination with development at higher level and with the development organisations. Linkage of social entrepreneur with Islamic banks/financial institutions and development department of the government may play an important role in this success. In respect of reaching out across these agents in the process of co-production, which plays a critical role in local level initiatives for natural resource, based initiatives for development. The process of their emergence makes them approximate more easily the notion of "sustainable development". Example is to be found in the Anadanda Bazar Patrika description (6th June, 2004) of the 'Islamic social capital' created by Monirul Islam. evidence from soil and water management in Darnka Village Panchayet in West

Bengal, India. In this aspect the "Islamic social capital" inheres not just in Muslim society but in the networks of relationships that span the public-private divide. The relative ease with which such networks can be developed at the local levels in rural areas comprises a significant input into their success. But the scaling up of this rural livelihood based initiative is made difficult and sometimes even impossible by another set of more formalised institutions embedded in societal structures. Some degree of centrally driven change in these overreaching legal, governmental, bank and market structures is an essential input for more lasting impacts on the nature of development.

4. Sustainable Development for Well-being

In order to discuss the linkages between social capital and development, we shall discuss that when the focus is on livelihoods at subsistence levels, the development intervention needs to be defined in terms of capabilities to enhance livelihoods to provide for improved levels of well-being. One is of course interested in continually enhanced levels of well-being in terms of a community in time. Sustainable development has been widely discussed in the literature and can be broadly referred to as "continuing development with appropriate levels of natural resources." More elaborately we can say that an economy is sustainable if it could save more than the combined depreciation on natural and capital goods. In the case study later we will argue that natural resource linked programmes have better employment and sustainable income prospects than directly poverty alleviation programmes of the government such as Integrated Rural Development Programme and other similar programmes. These Rural Development Programmes were initiated in India by the government for poverty alleviation based on asset and employment provision. We will argue in the following case study that appropriate institutions that enable people to realise their expectations with respect to the quality of life make development more comprehensive and more sustainable. The concept of sustainable development extends the notion of development in two different directions – directions that can be interpreted as holistic and inter-temporal respectively. Islamic social capital is relevant in achieving both.

5. Islamic Social Capital and Village Community Development

Muslim community development strategies should be rooted in livelihoods according to the Shari'ah and intended to strengthen the livelihood base. A study of one such experiment illustrates clearly that a reaching out by agents across the government, Islamic non-government organisation, market divide at the development process to result in the strengthening of Islamic social capital constituted an integral part of the experiment. The simultaneous presence of low income levels and degraded land in Darnka Village in Birbhum District of West Bengal in Eastern India led to the emergence in 1992 of an Islamic NGO initiative for development. The question rose what was the caused about this resource left as unutilised and how could better soil and water management lead to improved livelihoods? The answer was found that under-utilisation of the land was a consequence of the interaction of the nature of property rights and the minimum scale requirements for a successful intervention on water and soil management. Creating the natural capital on the basis of unity among the village Muslim families (re-educating the people about the principles of Islam and about the government rules and regulation) to initiate a process of development clearly required action in the area of changing property rights or an agreement on temporary pooling to solve the scale problem.

The initiation of the process of share cropping required bringing owners of land together to see that a pooling their utilised land could bring about a scale of operation that made it possible to adopt technologies of land and water management to intimate a process of

development. In this case a small Islamic NGO conducted such a dialogue with the people and its "Bila Sudi Qardh Scheme"(a non-profit interest free loan organisation) lead by Monirul Islam. The agreement lead to a determination of the extent of change in user rights which would be acceptable to owners of land. The final agreement in the village was the outcome of a careful balancing of the economic benefits from participation, the damage to social reputation by non-participation and the availability of an exit option to ensure credibility of the experiment. This part of the process was unquestionably the most challenging. But complementary inputs were garnered from Village Mosque committee, an Islamic welfare organisation, Cooperative bank through Darnka Village Panchayet and Block Development Office, Labhpur.

At the outset, the stakeholders in the process were clearly identified and their contribution in terms of land, labour or organisation identified. The unique Islamic sharing mechanism evolved by the Islamic NGO enabled income from the produce to be shared between workers and owners of land and also ensured that a part is kept aside for reinvestment. The evaluation of this mechanism and the keeping apart of a part of the Muslim community income from consumption loans constituted part of the networking between different social groups, which held the experiment together. It is a clear example of the creation of Islamic social capital that makes development succeed and was the input of the grass-root organisation.

The plantation and agro-forestry programme ensures three types of returns:- annual, once in 4-5 years and once in 10-11 years to meet short term basic needs as well as medium and long term needs for money income. A three-tier plantation programme with different gestation plants was conceived of keeping in mind both the terrain and the time related preference patters of the village people. Availability of some output at the end of a year to all participants ensured that people at low levels of income did not have to wait indefinitely for returns. A number of features of the norms and rules based on Islamic principles Mudaraba basis need to be pointed out, in particular as they are at variance with rules set down usually by government administered development schemes. These are transparency of distribution rules, the realisation that land owners as much as others needed to get a return on their inputs, the development of a three tier plantation system to cater to immediate as well as long term needed and the recognition that consumption loans needed to be catered to (from the non-profit interest free loan organisation of the Islamic NGO). Witness the contrast with emphasis of government initiated schemes on voluntary donation of land declared surplus by legal fiat and the preferential treatment given to production loans as against consumption loans under the Cooperative Bank scheme on profit and loss sharing basis (Musharaka or equity participation). The garnering of complementary inputs from other sectors of the economy constituted the next component of the creation of Islamic social capital. Experts within the group, who often relied on Agriculture Department or Central Agriculture Research Institute, developed technology for appropriate soil and water management. The basic water harvesting technology involved arresting water in situ and was known to the village people. Components such as tie-ridges, check-dams, ring-ridges etc were used depending on the terrain. Further, an initial one-time financial grant from Minority Development Corporation (MDC) of the

government enables the process to be initiated. The modelling of the development process, which was initiated, indicates that the effective taking off of the process depends on:

- (1) Clear understanding of land related property rights and of the extent of sharing that owners would agree to in their own interest and with a view to their individual reputations in the community.
- (2) Initially the transfer of resources such as land and capital,
- (3) The sharing mechanism set in place.
- (4) Depreciation rate of the capital stock.
- (5) Opportunity wage and rental incomes.

In sustainable development process, the first phase mentioned above is to pool the individuals out of poverty through the efforts of social entrepreneurs located both in the government and NGO. A scaling up requires a new network of vertical linkages with markets. Therefore, need to set up processing activity to use up excess production of vegetables and other crops. It needs training upgrading of skill and a new spurt of social entrepreneurship. Out of the above five process, the last two conditions indicate towards limits to such a localised process of development the process. There is possibility that natural capital stock may depreciate by a natural calamity. The same can be planned for- a rise in the opportunity cost of land or labour due to outside developments may render the local level experiment in development may not be profitable. It is needed to ensure that the resource productivity and thus return increases within this experiment, vertical integration with production processes outside the system is critical. It will require the creation of new social and economic networks and sometimes inputs of human capital.

It is important to note that the general parameters of the networking within which the developmental intervention was conducted were replicated in side by another village. A transparent process set up as a consequence of a "reaching out" between agents in different sectors comprised the basic starting point. This is the "Islamic social capital" that was put in place by the individuals who acted as catalysts.

6. Conclusions

The organisational advantage discussed in the paper is fundamentally a social one. The creation and maintenance of some forms of Islamic social capital, particularly the relational and cognitive dimensions are costly. The development of Islamic social capital this represents a significant investment- conscious or unconscious – and, like all such investments, requires on understanding of the relative costs and benefits likely to be derived from such investment. These are likely to be influenced by the size and complexity of the social structures in which Islamic social capital is embedded, since the cost of maintaining linkages usually increase exponentially as a social network increases in size. Although technology may make it possible to stretch the conventional limits of networks of Islamic social capital, arguments in this paper make significant of interdependence, interaction and closure suggest that there still remain important upper limits.

The development process initiated in predominantly village Muslim community in West Bengal in India is seen as the replication of the policy objective in line of some developing countries such as Bangladesh, Egypt, Indonesia, Pakistan, Sudan and other African countries. Achieving it with sustainability of resource use shall require indigenous crafting of sets of policy interventions, which use formal institutions, in conjunction with non-market process and institutions. The two are based on different premises and using them together in appropriate location specific contexts is the challenge. The concept of "Islamic social capital" is useful when interpreted as the networking between sets of agents located in different sectors of the economy, which is critical to the success of such development interventions. This networking creates the ground rules for transparent

functioning of development interventions and develops trust and coordinated action for development; innovative interactions between such agents also help solving problems such as free-riding and high rates of discount which typically prevent communities from conserving and harnessing natural capital for development. The model outlined in the paper also provides the foundation of a viable framework to guide the investments-individual or collective – of practitioners seeking to build or extend network of connections and therefore, their stocks of Islamic social capital.

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**THE INFLUENCE OF SOCIETAL SECTOR INSTITUTIONS' IN PROMOTING
LENDER-BORROWERS NETWORK RELATIONSHIPS
(A STUDY BASED ON THE ISLAMIC BANKING FINANCE TO RURAL-BASED SMALL
AND COTTAGE INDUSTRIES IN BANGLADESH)**

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1. Introduction

The Islamic banking system, a new innovation of Islamic financing techniques within the jurisdiction of Islamic Shariah (law) is playing an unique role in rendering financial services to rural-based small and cottage industries in many developing and least developed countries of the world. It is observed from the research (Alam 2002) that among other factors the lender borrower relationships between Islamic banks and the rural-based small industry owners are influenced by different societal sector institutions. Jansson (2002) in his studies observes that these types of institutions like country culture, family/clan, legal and political system and the government influence the economic and social life of a nation. The article is designed to demonstrate as to how and to what extent different societal sector institutions influences the lender borrower network relationships between rural-based small and cottage industry owners and Islamic banking organizations in Bangladesh.

Small and cottage industries (SCIs) play a predominant role in developing a nation's economy. The main contribution of this industrial sector is that it creates job facilities for many unemployed rural people in the country. Skilled workers can thus contribute towards the development of the national growth. One of the main hindrances of this sector is the lack of institutional credit. The Islamic banks in different countries have started investing funds towards the SCI sector and applying various Islamic banking funding techniques while giving loan to the rural-based small and cottage industry owners in a socio cultural environment of a country like Bangladesh. The study focuses mainly on different societal institutions in Bangladesh and their influences on the bank customer relationships between Islamic banks and small and cottage industry owners. Besides many traditional banks, in recent years, Islamic banks started giving loans to rural based small industry owners. Due to the influences of the societal sector institutions like other financing organizations, Islamic banks are also facing acute problems in rendering their financial services in the money market of Bangladesh. The result reflects in this article is an outcome of the analysis of data collected through empirical studies carried out in different rural areas in Bangladesh. In order to study this phenomenon, I used the 'Institutional-Network' theoretical framework (Alam, 2002), developed to study the lender-borrower network relationships between different lending organizations and small and cottage industries in the context of the money market in Bangladesh. The theoretical framework is developed based on Whitley's (1992a 1992b) 'Business Systems' institutional concept and Jansson's (2002) 'Network Institutional' model. Whitley in his study

highlighted on differences between firms within different business systems and the influences of different societal sector institutions in many Asian countries, while Jansson (2002) used his model in studying differences between different Multi National Corporations (MNCs) in India.

Apart from the introduction, the article consists of four different sections. The first section includes a brief description of the theoretical and methodological aspects of the study. The second section introduces different societal sector institutions studied and the third section includes a brief description of different financing modes used by Islamic Banks in Bangladesh. The last section includes a detailed analysis of the findings of the research especially focusing on the impact of the societal sector instructions on the lender borrower network relationships between Islamic banks and the rural based small and cottage industry owners in the country.

In order to understand the lender-borrower relationships in depth, a qualitative nature of research methodology was used in the study. Since case studies reveal various facts about a particular phenomenon and allow a researcher to get very close to his or her informants, I used a case study method while collecting data from the field. I interviewed different Islamic banks and their clientele; rural-based small industry owners, in different rural areas of Bangladesh.

2. Theoretical and methodological approaches

As mentioned above, based on Whitley's (1992a) 'Business System' institutional approach, I developed an analytical frame of references to study both the lender-borrower relationships between different financing organizations and rural-based small and cottage industries and the influences of societal sector institutions on their activities. The theoretical model is applied to study and analyze the exchange functions between Islamic banks and borrowers, especially rural based small and cottage industries in Bangladesh. The model is designed in such a way that different small and cottage industries and financing organizations of similar nature studied are grouped and institutionalized into different SCI systems (Small and Cottage Industry Systems) and different Financing Systems (FSs). In order to achieve the objectives of the study, the concept of four components of different SCI systems and financing systems are developed in the theoretical model. These components for example, are nature of organization, market organization, employment systems and authority and control systems. Like Whitley's (1992b) 'business systems' (BSs), the Islamic financing system is seen as a 'Financing Business System' (FBSs) of its own, with a foundation based on religion, having its own rules governed by the Islamic shariah (laws). These rules differ from those of other financial systems. Different other financial systems, for example; the market based financing system (MBFS) such as conventional banks, the cooperative financing system (CFS), and the traditional money lending system (TMLS) viewed as particular arrangements of hierarchy-market relations that become institutionalized and relatively successful in a particular context. A similar arrangement in the theoretical model is also done to institutionalize different rural-based small and cottage industries. Small and cottage industries of similar nature studied are thus grouped into three different SCI systems. These are for example, the Grass-root Level (GL), the Season-Based (SB) and the Semi-mechanized (SM) SCI systems. Since, the network relationships as an important part of the hierarchy-market relationships is poorly developed in Whitley's (1992b) 'Business Systems' approach, concepts of Jansson's (2002) the Network Institutional Model was also taken into consideration while developing the theoretical frame of references in the study. In his network institutional model, Jansson (2002) highlights network relationships between the multinational corporations (MNC) in India and major external parties in the product/services market like customers, intermediaries, competitors and suppliers. It also gives some examples of external institutional factors that affect the networks. Like the network relations between the MNC and major external parties, financial organizations in the present study as observed influence and are influenced by various commercial actors in the financial as well as

non-financial markets in Bangladesh. The theoretical model also includes the concept of Jansson's (2002) societal sector institutional influences like country culture, legal systems, religion, family/clan, government etc., that have direct or indirect influences on lending and borrowing activities between different financing organizations and the rural-based SCI owners. Since one of the main objects of the study is to see as to how and to what extent various societal sector institutions influence the network relations between financial organizations and other major external parties in the financial market, especially the SCIs, regarding the use of the network approach among many others (for example, Rasmussen, 1988; Kuklinski & Knoke, 1988; Anderson and Carlos, 1976; Easton & Araujo, 1991; Elg & Johansson, 1992; Easton, 1992; Håkansson, 1993; Aldrich & Whetten, 1981; Emerson & Cook, 1984.). I found the concept of Jansson's (2002) model appropriate for the present study. The theoretical model reflecting the influences of the societal sector institutions is shown below in figure 1.

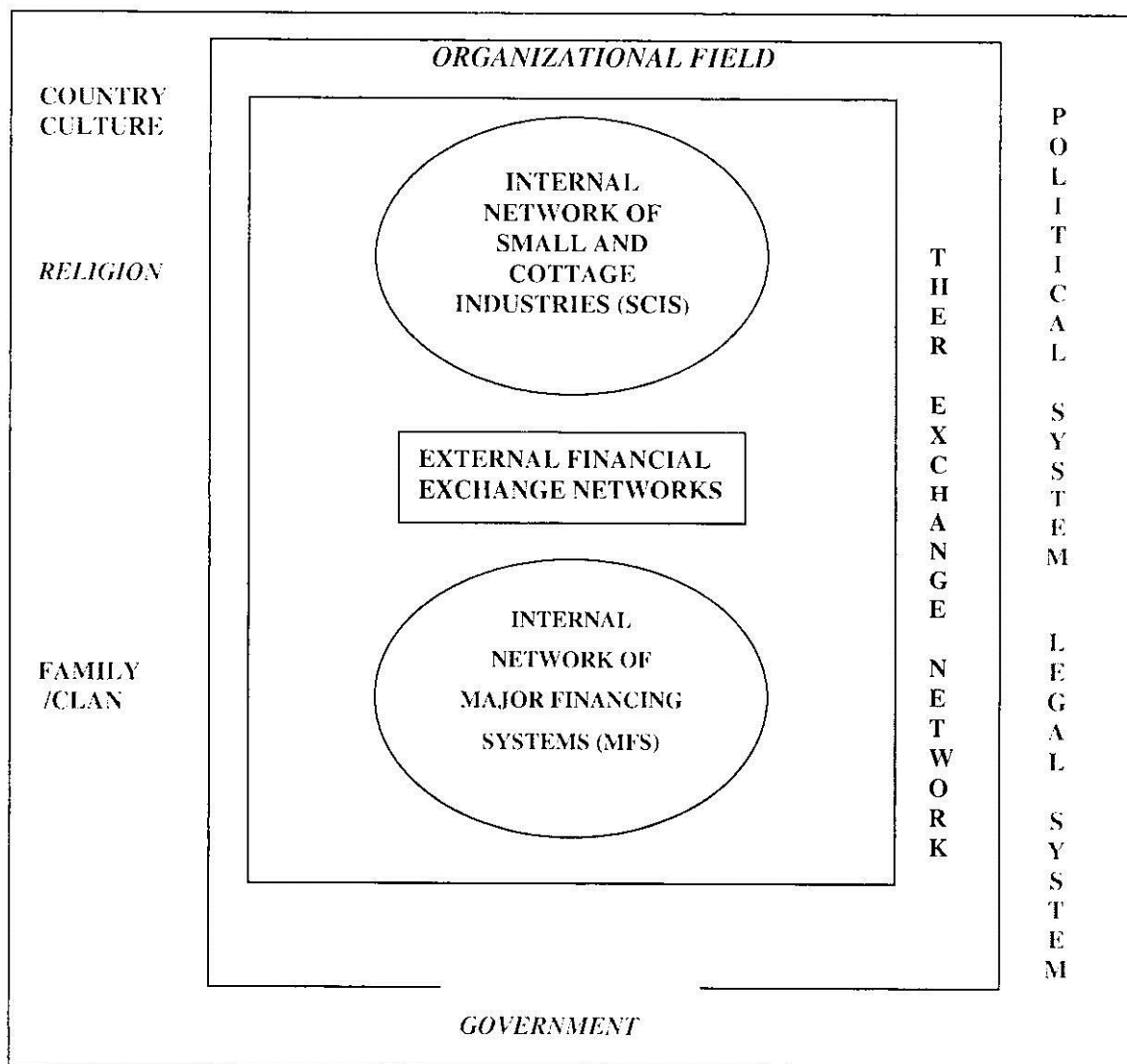


Figure 1: The 'Institutional Network Framework (Alam 2002)

The above-mentioned Institutional Network Model, which is developed to study the present phenomenon, consists of three major fields. Since the relationships between internal networks of the SCIS and MFS are mainly financial, the financial exchange network is focused on between these two institutions. The second box consists of the product and service exchange network as another organizational field influencing the organizational field in the first rectangle. As the activities and the network relationships of network actors of various institutions in these two organizational fields shown in both the first and the second rectangles, are influenced by societal factors like country culture, religion, family/clan, political system, legal system and government, these institutions are placed in the outer rectangle in order to study their influences on the network institutions within and between the organizational fields.

2.1 Methodological Approach

The methodological approach used in the study is a combination of both **deductive and inductive**' (Glaser 1978, Strauss & Corbin 1990, Jansson et.al.1995). In the deductive approach, one tests the hypothesis or the validity of a theory. It is a method by which one may study an individual case using a general law – that is, a logical analysis of what the general theory says about a specific event. Initially, the research design was based mainly on Whitley's 'Business Systems' institutional theory (1987, 1990, 1992a, 1992b), and Jansson's (2002) the 'Network Institutional' theory and network theories of Kuklinski & Knoke (1988), Johannisson et al (1992), and Håkansson (1993). The inductive approach principle means a journey made by a researcher from the empirical point to the stage of a theory development. At one point in the work, based on the data collected from the field I interviewed various financing organizations as mentioned in the above section and modified the originally defined theories and developed a theoretical frame of references- based on which data collected from the field are analyzed. The research methodology applied in the study is of a **qualitative nature** (Jick 1979; Merriam 1998; Sherman and Webb 1988; Patton 1985). A qualitative type of research is characterized by collection of data directly from respondents in the field. This is because the entire research program is based on facts acquired from the material world, that is, the practical field of study. **'In-depth' interviews** with senior officials of different Islamic banks and conventional banks and their customers especially small and cottage industry owners in rural Bangladesh were conducted during the field work A **case study** (Yin 1994) method was adopted as a research strategy in order to focus on contemporary phenomenon within the real life context of different Islamic banks and other conventional banks and their relationships with their customers, especially the rural-based small and cottage industry owners.

3. General concepts of the term 'Institution'

Institution is viewed by the International Encyclopedia of the Social Sciences as norms and rules of conduct that are usually regarded as the basic focus of socio-economic organizations.¹¹⁰ Hughes (1939, P.283) in his discussion observed that anything socially established could be called an institution. The author further suggests that the term institution is applied to those features of social life, which outlasts biological generations or survives drastic social changes that might have been expected to bring them to an end. While highlighting the 'Institution Theory', Oliver (1990) argues that an institutional environment imposes pressure on organizations to justify their activities or outputs. These pressures motivate the organization to increase their legitimacy in order to appear in agreement with the prevailing norms, rules, beliefs or expectations of external constituents. Institutions greatly influence human activities as well as the behavior of markets, various

¹¹⁰International Encyclopaedia of the Social Science, Social Institution, Vol. 14: 409-429.

organizations and individuals within a society. According to Jansson (2002) institutions also concern different types of habitual or recognized behavior such as habits, rules, and procedures, implying that institutions are characterized by a rule-like or governing nature, an ability to facilitate and constrain inter-human and inter-social relations, and by predictive behavior. Veblen (1919, p.239) observed that institutions themselves are comprised of settled habits of thought common to generality of men. Man is socialized by societal agents and forces, thus habits are an outcome of social behavior, customs, traditions and law.

3.1 Societal Sector Institutions: A conceptual review

This section includes a conceptual review of different societal sector institutions that influence the exchange activities and the lender-borrower network relationships between economic actors in a financing system and a small and cottage industry system. As mentioned in the earlier section, Jansson (2002) in his 'basic institutions model' highlighted certain institutions such as religion, state, family/clan, and country culture. These are specific institutions that influence activities of various actors in an organizational field. A brief conceptual review of these institutions is given below.

Religion

In almost all societies people are cognitively and morally guided by some personal faith or attached to some specific religion. Religious organizations like churches, mosques, temples etc. have great historically exercised influence on the economic as well as the social activities of a nation. Religious faith directs man towards the development of moral and ethical value and norms.

Religious institutions play an important role in developing a consolidating faith among people in a society. Strong religious value provides a potential binding-force for people. For due to its influence identical or at least similar ideals and norms develop within society, which in turn makes economic activities more efficient and effective.

Religion, which teaches value of social justice and love for each other, could therefore be an important factor for the running of economic activities. The majority of religion and trust for example, are correlated. Religious norms and values may thus help in promoting trust in individual, social or professional life and strengthen relationships among individuals within society thereby countering opportunism as an operative principle. Thus, the efficiency of the Islamic Financing System under MFS is constructed by certain rules originating from the religious system in form of certain norms and rules.

Religion disciplines human nature. Therefore, law and order situation may be achieved in a better way where religious faith and its practice are stronger. Delegation of authority work better in an environment where there is strong belief between a boss and a subordinate. In religiously developed societies a good chain of command works smoothly. In order to develop moral values and establish a better social environment religious value may play a predominant role. It is due to the fact that, the root teaching of every religion is to develop trust in each other's activities and to implement social justice with love and cordiality among ones fellow friends in a society.

Like any ordinary business systems, certain Major Financing Systems (MFS) in a market economy are also influence by religious norms and thought styles.

The State

Regarding state Hodgson (1988, p. 153) observes that the state must be concerned more than 'government' as it is the continuous administrative, legal bureaucratic and coercive system that attempt not only to structure relationship between civil society and public authority in a polity but

also to structure many civil relationship within civil society as well. The State often plays a direct role in organizing exchange relations in every society. As an institution it regulates the premises, which faces economic institutions by manipulating various social institutions e.g. by improving the legal system. Apart from that the state has direct control of economic activities in the country, which is mainly exerted through introducing various rules and regulations. State institutions take active part in motivating home producers to develop industrial products by controlling import and export systems. By legislation states control the buyer-seller relations that facilitate favourable market conditions both within and external to the country. Activities such as, import of raw materials, export of finished products and participation in any international trade fares etc., which have a great influence in the development of a nation's economy are regulated by the state. Various social and commercial activities are rule-bound and are as such bound to have a great effect on individual, business, industrial and all other economic sectors in the country. The state has direct and indirect control over various industrial and financial systems.

The first feature is characterized by dominant role of the state as well as its authority and resources. This is a situation where the state has an absolute and unchallenged authority to implement its ideas for economic activities alternately expressed as a 'hard' state function. For example the military regime in Bangladesh during last decades can be cited as an example when overall economic activities were controlled by the state, as it was the case in South Korea and Taiwan in the year 1960s, 1970s and 1980s. Military governments in these cases were able to implement their policies and dominate the bureaucracy. Under a democratic type of government, on the other hand, state must share power alone. Power in this case is separated between the legislature, the executive and the bureaucracy. In theory no single component can dominate the other. Societies in which economic activities are carried out jointly by political, bureaucratic, and industrial elites need to share common objectives, without which the state will be unable to attain the desired goal.

Country Culture

Country culture and social relations influence activities of both market organizations and financing systems. People in an economically developed society enjoy various facilities to live a better life and to develop both their culture and standards of living. Mutual cooperation and periodical interaction among people in all walks of life are common features of this type of society, which ultimately leads people to constitute benign economic environment. Business communication can readily be developed if cultural ties are strong in a society. The primitive usage limit the concept of culture as suggested by Meyer et al. (1977), to a cluster of consensual general value such as religious faith and morality and a body of consensual knowledge or technique such as scientific rules. China, among Asian countries can be cited as a unique example, where strong cultural ties contributed greatly towards the economic growth of the nation. Regarding relation orientation qualities of business transactions in Chinese societies, Jansson (1994) observed that these are derived from basic characteristics of Chinese culture generally, in particular, the importance of the family and of other relationship, as well as a tendency towards short-sightedness. The study of Jansson (1994) where a classification of interpersonal relationship in Chinese societies is made, may be applied as an appropriate approach to study the social and cultural ties between economic actors in the society of other Asian countries, like, Bangladesh. The discussion of different types of relationships between social units in Chinese societies gives a general idea of how social ties in Asian societies are established.

Relationship in a society can be strengthened in many ways, for example by intermarriage, ceremonial or social intercourse, visiting, giving gifts or inviting persons to important family events and festivals.

Limited (ICHC). A few Western banks such as, the Kleinworte Benson, Citibank and ANZ Grindlays also started to adopt the pattern of Islamic banking in cost-plus financing, leasing and equity financing for their clients in the Middle East, Southeast Asia and a few international corporations in Europe and Latin America (Gathura; 1996, Roula; 1995, Ken; 1994, Parker; 1993, Heffernan; 1999)

Acceptance of Deposits under Different Deposit Accounts

A brief description of the nature of these accounts is given below.

Current Accounts

Islamic banks accept deposits from customers on current accounts as conventional banks do. This account is also known as 'Demand Deposit' as the deposited amount is payable to customers on demand without any notice. As banks use current account deposits on their own risk the depositors of this type of account are not entitled to any share in the profit earned by the bank.

Savings Accounts

Islamic banks accept saving deposits from customers under Al-Wadia and Al-Mudaraba Sharia Principles. The word Al-Wadia means 'Trusteeship'. In this case banks act as trustee for its customers. In Saving Accounts under the Al-Wadia principle the bank is given an authorization by depositors to use the fund at the bank's own risk. This type of deposit is almost similar to a 'Current Account' or 'Demand Deposit' except that the bank guarantees its customer the full return of the deposited fund with any profit voluntarily.

Investment modes used by Islamic banks

An Islamic bank renders similar services to their customers as other conventional banks but due to the differences in the principles of Islamic banking systems the modes or techniques of accepting deposits and lending funds to customers differ from conventional banks. The following are a few of the investment modes that an Islamic use while investing funds in different projects.

Mudaraba or Capital Financing

Under the Capital Trust Financing or Mudaraba mode of financing Islamic banks supplies the entire capital of the business and the customer gives his time and expertise, which form a relationship between the supplier of capital and the user of capital. Thus the bank and the customer work together and share profits and losses.

Musharaka or partnership financing

The word 'Musharaka' means a profit sharing joint venture, designed to limited production or commercial activities of long duration. In this case the bank and the customer contribute capital jointly. They also contribute managerial expertise and other essential services at agreed proportions. Profit or losses are shared according to the contract agreed upon. An individual partner does not become liable for the losses caused by others. Due to this joint venture this technique is also known as Equity Participation mode of investment. Profit is distributed according to a predetermined ratio and loss, if any is also shared according to the capital ratio. Both the bank and the customer take part in the management and control of the entrepreneurial activities.

Murabaha (Mark-up or Costs-Plus- Profit based financing)

'(Khoja & Ghuddah (1997, chap. 1 p.2), states that the mode of Murabaha sale connected to a promise is used by the Islamic banks which undertake the purchaser of commodities according to the specification requested by the customer. The bank then resell them on Murabaha to the one who promised to buy for its cost price plus a margin of profit agreed upon previously by the two parties. Under the Murabaha mode of investment the bank agrees to purchase for a client who will

then reimburse the bank in a stated time period at an agreed upon profit margin. The mark-up price that the bank and the buyer agree to is mainly based on the market price of the commodity. Thus the bank earns a profit without bearing any risk.

Bai-Muajjal or cost plus sale under deferred payment

The Bai-Muajjal mode of investment is as like as a Murabaha mode of investment with an exception that the sale under this cost-plus sale modes investment is made on a credit basis rather than cash. The main feature of this technique consists in procurement of goods at the request of the client and selling it to him on credit. This mode follows the same conditions as Murabaha mode of investment except the following:

- The bank transfers the possession of goods to the client before payment.
- In order to cover the sale price of the goods the bank obtains collateral securities from the client.
- The bank normally takes property of Municipal area as mortgage. In case the client fails to repay the sale price the bank realize the amount by selling the mortgage property.

Quard E Hasan

Quard E Hasan means an interest-free loan given by the Islamic bank to the needy people in a society. The practice of dealing with this sort of investment differs from bank to bank. Quard E Hasan is normally given to needy students, small producers, farmers, entrepreneurs and economically weaker sections of the society, who are not in a position to obtain loan or any financial assistance from any other institutional sources. The main aim of this loan is to help needy people in a society in order to, make them self-sufficient and to raise their income and standards of living.

5. Influences of the societal sector social institutions: An analysis of the empirical studies

Based on the data collected from the field research, this section includes a detailed description of the influence of societal sector institutions on the network relationships between the economic actors in IFS and SCI systems in Bangladesh. In order to study the influences of different societal sector institutions (see section 3.1) on the exchange activities of the IFS and different SCI systems, I interviewed more than 200 rural-based small and cottage industries, in various parts of Bangladesh. The majority of the respondents are customers of the Islamic banks. As mentioned at the beginning of the article respondents of small and cottage industries are categorized into three different categories according to the nature of their activities. These are Grass Root Level (e.g. poultry and diary firms), Season-Based small and cottage industries (e.g. fish firms), and Semi-Mechanized small and cottage industries (e.g. salt industries and furniture industries). I also interviewed three Islamic banks and four commercial banks. These financing organizations are involved in lending funds to the rural based small industry owners. From the respondents perspective the research results are shown in the following section reflects as to how different societal sector institutions influence on the exchange activities between small and cottage industry owners and the funding organizations, especially Islamic banks.

Religious Systems promotes obedience and loyalty and develop saving mentality

The societal sector institution of the religious system relates to various features of the organizational fields like loyalty and obedience, boss-subordinate relationships and trust. As majority people in rural Bangladesh are Muslim, they more or less practice religion in their daily life. Even though in many SCI systems practicing Muslims are not many, yet almost all persons have faith in the basic Islamic principles, which make them to develop lender-borrower relationships with the IFS. Since the IFS belongs to a particular religious system, besides financing, rural people are educated from particular religious viewpoints about the advantages of the unity

and trust as well as obedience and loyalty. In that way religious faith and religious teachings promote the lender-borrower network relationships between the IFS and different SCI system as well as *intra-organizational* network relationships.

Features of the grass-root level and season-based SCI systems are influenced for example, managerial discretion from owners, supervision and control, delegation of authority, and degree of loyalty and obedience. As it is a custom in society that religious leaders teach how to show due respect and regards to elders, this helps to develop obedience and loyalty by juniors to their senior in the family as well in the organizations. It is known from the study that the religious attitude among SCI owners has an impact on the centralized supervision and control of SCI units within different SCI systems.

Unity and integrity are also some of the importance teachings of the religion, which influence the organizational routines of different SCI systems and the IFS. Behind the more intense relationships maintained between the grass-root level and season-based SCI systems and the IFS are found religious faith influencing the obedience and loyalty of workers in these SCI systems. Thus, it is concluded that the religious system assist in promoting the *inter-organizational* networks between the SCIs units the financing organizations within the IFS. The more this loyalty the higher seems to be the degree of the sense of loyalty and obedience to seniors. Since the IFS is characterized by religious rules and regulations, the degree of loyalty and obedience between senior-juniors high in this financing systems compared to other financing systems. Similarly, religious attitudes and religious teachings develop sense of regards and respects to seniors by their juniors in different SCI systems. This ultimately results in promoting the obedience and loyalty between seniors and juniors. It is therefore concluded that like the inter-organizational networks the religious system contributes in developing the intra-organizational network relationships among workers in both SCI units in different SCI systems and financing organizations in the IFS.

It is also understood from the study that in the case of grass-root level and season-based SCI systems, the degree of the personal authority of owners is higher than in the semi-mechanized SCI system. This higher personal authority indicates a higher dignity and position in the system, which inter alia, senior staff members obtain from the cordial and sincere behavior of their juniors. The religious system thus influences the development of habits among workers, for example, to rely on the decision of the top managers and to increase the degree of the obedience and loyalty to their boss. It is found from the study that the boss or the owner of a particular SCI unit is not looked as a manager or boss in commercial term, which is a normal practice in the Western society. Rather the boss is seen as a head of the family for example, father, mother, or any other elderly person. Hence, the personal authority is not looked up on from perspective of a commercially oriented firm but from the senior junior relationships in a family. Religion teaches in our society how to respect elders and to obey their instructions.

There is also a negative impact from the religious system, sometimes paralyzing the overall progress of the SCI owners. It is found from the study that in order to exploit uneducated poor people many religious leaders abuses the religion or religious system. In the name of religion they take undue advantages from them. It is to be noted that the religious system in our society is not well organized and many priests find their own way of introducing religious activities. Religiously ignorant rural people hardly understand what is right or what is wrong from the viewpoint religious beliefs. The rural-based SCI owners thus become the victims of not the religion itself but of the so-called religious leaders who normally exploit them in the name of the religion. It is found from the study that in many cases due to the influences of the wrong teaching of the so-called religious leaders in society many rural-based SCI owners spend their money in unproductive ways.

However, the IFS is guided by the Islamic principles incorporated into the lending process and manifesting themselves in educating the rural people and highlighting them about the reality of religious faith. This promotes the lender-borrower relationships, at the same time as it develops religious faith and makes the SCI owners religiously conscious.

Another conclusion from the study is that the religious system influences the saving habits of the rural SCI owners. The Islamic religion prohibits spending habits like drinking and using drugs, as well as develops the mentality of the people and directs them towards spending money in productive activities. In rural Bangladesh, due to ignorance and less education, the majority of the people are habituated in spending their savings on many unproductive sources. Moreover, in many rural as well as urban areas, young generations are becoming more and more involved in many unsocial activities like using drugs, and creating social unrest, which not only hamper the social security but also influence the saving ways of rural people. As the IFS lending procedures to the grass-root level SCI system is regulated in accordance with the Islamic ideology, the financing system through its lending policy develops the savings mentality among the rural people. The saving habits thus developed save the rural SCI owners from the unnecessary use of funds in unproductive activities and also deepen the trustworthy network relationships between the lender and borrowers.

‘ Family/ Clan’ a means of promoting boss-subordinates relationships

The family/clan relates to various features of the organizational field like boss-subordinate relationships, centralization of decision and delegation of authority. Family ties may be termed as ‘expressive ties’ (Jansson, 1994) where people of the same family or clan work together in the firm. It is understood from the study that due to the nature of the ownership and also the nature of production activities, the semi-mechanized SCI system mostly depends on the outside workers, while grass-root level and season-based SCI systems are characterized by a strong family ties and almost all activities of the SCI being organized and run by the members of the family. In case there is no skilled worker among the members of the family the SCI owners employ workers from outside, who are mostly appointed from their own clan. Since the members of the family and or the clan work jointly in the grass-root level and the season-based SCI systems, the degree of obedience and loyalty to seniors is high in these SCI system compared to the semi-mechanized SCI system. This in its turn results in the intense boss-subordinate relationships. As the family head takes most of the decisions, the season-based and the grass-root level SCI systems are characterized by the lower degree of delegation of authority than the semi-mechanized SCI systems.

It is also found that the combined efforts of members in the family for any productive activity increase the degree of unity, which results in developing close ties and network relationships among workers in the SCI systems. Since unity among family members increases trust for each other, the lending organization finds it easy to carryout the exchange functions. It is therefore concluded that the unity among the members or the clan in any SCI system promotes the lender-borrower relationships between the SCI owners and IFS.

The close family tie influences the saving habits of rural people. It is understood from the study that because of the close ties between the members of the family of the grass-root level SCI system, they are more used to spend or save money according to the direction of their family head. Since the boss is having the direct control over the spending habits of the members of the family, unnecessary expenditures are avoided which results in the increase of savings. It is found that this feature of the family/clan has encouraged the IFS to introduce a savings oriented lending system to this grass-root level SCI system.

‘Country Culture’ promotes both business and personal network relationships

Country culture mainly relates to basic habits of the rural based SCI owners, mainly the observance of various cultural functions and ceremonies like birthday, death anniversary, marriage ceremony and other similar functions. The habits may have a base in one societal sector, for example religious system, but have a wider practice of not only being confined to a particular institution or societal sector. These occasions influence the spending habits of the rural people, for example, in that way having both positive and negative effects on the activities of various SCI systems and IFS.

It is found that due to these cultural functions the demand of the grass-root level SCI products grows higher than for other two SCI systems. This results in the increasing of the production and sales volumes, which ultimately influence the growth of the firm. In Bangladesh, for example, marriage ceremonies mostly take place in a particular season, when there is a high demand of SCI products like furniture produced in the semi-mechanized system. A conclusion from the study is that due to such cultural factors the demand of products produced in the grass-root level and semi-mechanized SCI systems increases more than for the season-based SCI system.

Country culture again influences the development of intense network relationships between SCI owners and various interest groups in society. Since cultural functions are organized by clubs, societies, religious, social or political leaders, they maintain direct contact with different SCI owners to buy products from their services. Therefore the network relationships of the grass-root level SCI system with other interest groups in society are more intense than those of the other two SCI systems. This factor also indirectly contributes to developing good and intense lender-borrower relationships between the grass-root level SCI system and the IFS.

Country culture is also characterized by many negative results that impact on the social and economic life of rural people. The study shows that spending money for various cultural functions like ‘dowry’ in marriage ceremonies, circumcision of boys or girls’ are some of the negative sides of the country culture, which lead the SCI owners to spending funds on unproductive sources. These result in increasing problems in exchange functions between the economic actors in both IFS and SCI systems.

‘Legal Systems’ a problematic and time consuming system for both SCIS and IFS

The grass-root level and season-based SCI system are characterized by less or no requirement of observing any legal procedures to start their business while it is a must in case of the semi-mechanized SCI system. It is understood from the study that as the relationships of the IFS and grass-root level SCI systems are more informal than the mechanized SCI systems. The financing organizations due to their informal contact and constant contact with the borrowers in the SCI not only make them active in their productive activities but also punctual and regular in their financial dealings. It is also found that with regard to the semi-mechanized SCI systems, sometimes organizations within the IFS require to take legal actions due to default in paying debt regularly. As firms within the semi-mechanized SCI systems are bigger in size than firms in the other two SCI systems, this SCI system is more influenced by the country’s legal system, e.g. payment of taxes like VAT. Since the semi-mechanized SCI system is featured by higher degree of the capital intensity and wider scope of marketing of products, the degree of its involvement with country’s legal systems is higher than those of grass-root level and season-based SCI systems.

It is understood from the study that to avoid any legal procedure, which organizations within the IFS find time consuming, and sometimes problematic due to the involvement of corruption, trustworthy network relationships are established with customers. This is facilitated by the religious base of the IFS, which increases trust between exchange partners. Similarly SCI owners also try to

avoid any legal matter, where they build up personal trust with the IFS organizations through intense lender-borrower relationships

‘Political System:’ oriented by political unrest and discouraging factors

It is understood from the study that the rural based SCI owners in different SCI systems are among the worst sufferers due to the political unrest in the Bangladesh. The adverse effect of the political system also creates problems for the IFS to properly maintain and supervise exchange activities. Due to strikes and lockouts different SCI systems fail to keep their commitment to customers to supply goods and also to transport raw materials in due time, which ultimately hamper the establishment of trustworthy relationships. Sometimes the activities in different SCI system are controlled by local political leaders. The political system is again related to the country’s legal system. Due to undue influences of the political leaders the legal system sometimes fails to work properly. In such instances the SCI systems become victims of the both legal and political systems.

‘Government Policies’ causes miseries to SCI owner

It is concluded from the study that since the government is solely responsible for policy formulation and its implementation in various sectors of economy the role of the government has direct as well as indirectly affects on the lender-borrower network relationships. The study demonstrates that as the government mechanisms in the country are influenced by the leaders in the ruling political parties, the frequent changes in the government also causes changes in government policies, which results in miseries for many SCI units in the SCI systems. It is also found that although the government is concerned about the development of the infrastructure facilities for the rural based SCI units in the SCI systems, yet due to the frequent changes in the government, no remarkable progress has been made to enrich this particular sector of economy since independence. It is also concluded from the study that the financing organizations within the IFS face problems in maintaining proper exchange relations with their customers, since the government policies, like open market operation, export import policies, do not favor these organizations. It is also found that due to the direct involvement of the ruling political party in the government in many cases policies adopted by the previous government for development activities are not materialized by the ruling government, instead new rules are implemented. Thus, it is concluded that the instability in both government and government policies not only affect the lender-borrower relationships but also stand as a major barrier in maintaining stable network relationships between organizations within the IFS and SCI systems.

6. Conclusion

In conclusion it may be said that although different societal institutions like family/clan, religion, country culture and legal system have positive influences in promoting the lender-borrowers network relationships between the actors belonging to the Islamic financing system and the small and cottage industry system, yet political unrest and of a sound government policy for SCI stand as great hindrances in development and progress of the rural-based small and cottage industries in Bangladesh. A developing nation like Bangladesh needs a stable government with well-organized and established state policies. Unfortunately, it is observed that with the change of the government with different political parties the policies of the government also change. Corruptions are common features among political leaders. Due to the lack of proper government care, corrupt leadership and lawlessness in society, small and cottage industry owners do not feel safe and secure to invest funds in any project. The little money they own the rural people want to invest in a profitable project and expect to earn maximum profit from their invested funds. A stable government with unbiased political leaders and a sound legal system contribute a lot in promoting rural based small and cottage industries. The Islamic financing system can contribute more towards generating employment opportunities and remove poverty in the rural areas of Bangladesh by providing

necessary funds to small and cottage industry owners, once they find a stable government with good leaders and sound political systems with established law and order in the society.

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THE 'MISSING LINKS' BETWEEN ISLAMIC DEVELOPMENT OBJECTIVES & THE CURRENT PRACTICE OF ISLAMIC BANKING – THE EXPERIENCE OF THE SUDANESE ISLAMIC BANKS (SIBS)

By: *Badr El Din A. Ibrahim*¹¹¹

Introduction

Islamic banking is the fastest growing segment in the banking system: its market share of assets has risen from 2% in the late 1970s to 15% up to the mid-1990s.¹¹² Moreover, capital, assets and deposits have grown by a rate between 15-20% during the last three decades. If this trend continues, it is anticipated that Islamic banks would share between 40-50% of the Islamic world's savings within the next ten years, excluding savings in traditional banks' Islamic avenues in USA and Europe¹¹³. The strong presence of Islamic finance all over the world of more than US\$ 200 billions of assets, together with a total world share of Muslim population of around 20% (equivalent to around 1.2 billion), raises the question of how these financial institutions contribute to the economic and social development of the Muslim world? No doubt, the phenomenon of Islamic banking is a fascinating development in the history of international finance. They have not only managed to survive and grow under the pressures of today's global market, but at the same time, are being governed by religious principles. Nevertheless, the question as to whether Islamic banking will make the much-expected contribution to investment and growth, poses a challenge for bankers, researchers and policymakers alike.

The paper will try to investigate the 'missing links' between Islamic finance and development objectives in the world of today. It will broadly review the operations of the Sudanese Islamic financing, in an attempt to perceive the link between finance and economic development objectives in Sudan. We hypothesized that the present Islamic banking strategy to achieve economic development unfortunately, is still under trial, despite the fact that more than two decades have lapsed since the inception of the first Islamic institution in Sudan. In order to give some evidences about the developmental and social role of ISBs, the paper will test the following: the geographical distribution of ISBs in Sudan, short versus long term investment, credit by modes of financing used, sectoral distribution of financing, role in poverty alleviation, harmonization of the *Shari'aa* rules with economic thinking to cope with today's modern and global world development constraints, and the developmental role of ISBs within globalization. The paper will also raise some thoughts and throw light on how to integrate Islamic finance and economic development in a world of today.

Theoretical Background

The western mode of development and production is built on three pillars: Economic freedom and self-interest, achievement of maximum possible profit, and dominance of market forces. This mode of development, described by Mannan, as "development as if people were not matter",¹¹⁴ is not wide-ranging and is associated with many negative outcomes, such as shortages of demand,

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¹¹² Tarik Yousef, 1996-1996, "Islamic banking and financial development and growth", *Forum*, Vol. 5, No. 5, Sep.

¹¹³ Islamic Development Bank (IDB), 2002, *Annual Report*, IDB, Jeddah, Saudi Arabia.

¹¹⁴ Mannan, M. A., 1984, *The making of Islamic society*, International Association of Islamic Banks.

weakness of individual interest to achieve public needs, and the discrepancy between private and social costs and benefits (externalities). This pattern of development is usually associated with negative macroeconomic and environmental outcomes such as stagnation, inflation, external deficits and environmental degradation. This pattern is simply financial-specific, concerned with the ways and means to enhance "capital accumulation" in order to achieve maximization of profit, neglecting the religious and spiritual dimensions and leading to social and environmental damages.

On the contrary the theoretical Islamic development philosophy is about diffusion of development benefits between massive rural development (where the bulk live) and equitable distribution of income. It is inclusive (including, social, financial, and spiritual dimensions), and is based on the belief that all wealth belongs to *Allah* and individual owners are trustees of that money. Moreover, private investment in Islam is dualistic in nature for the simultaneous prosperity of both the investor and the community. There are many principles which tend to guide investment in the Islamic world. One of these principles is the use of money and investment to provide basic necessities to society as a whole. Also, these principles determine some rules concerning priorities and avenues for investment and its mechanism. These objectives of Islamic circulation of money and investment are the basic objectives of an integrated Islamic financial institution. Tarik Yousef argued that: "*The means by which Islamic banking would fulfill these goals (i.e. developmental goals) in today's financial climate, was neither clearly demonstrated in economic theory nor in historical and contemporary experience*"¹¹⁵ (emphasis between two brackets is added). On the contrary the writer believes that there is no confusion among both scholars and practitioners of Islamic financing concerning the general theoretical developmental objectives of Islamic finance. Nevertheless, it seems that there is no readily available mechanism to achieve these objectives of development via Islamic financing in the world of today. This is partly due to the lack of vision of how to put these objectives into practice due to multiple reasons such as the national and global environment, the ways Islamic banks have been operating and the lack of ideas to integrate Islamic financing with the social objectives in practice supported by the fact that Islamic banks of today have been created from scratch with no modern experience preceding their presence.

Islamic banks were expected to mobilize savings and allocating investment, and providing a vehicle for economic growth, by offering instruments compatible with Muslim religious beliefs and cultural customs. Most significantly it was expected that Islamic banks would facilitate long-term capital formation by providing long-term risk capital to the productive sectors. They were also expected to focus more favourably at investment opportunities and modes of finance thereby maximizing social returns and economic sectors and facilitating long-term development. The Sudanese Islamic banks (SIBs) are no exception. The following sections assess the role of these banks in economic development of Sudan along these lines.

SIBs: An Overview

The Sudanese Banking system is fully Islamized. It comprises of 21 national banks (all are Islamic and mostly private banks) with 533 branches. There are 3 Specialised branches and there is no foreign bank¹¹⁶. The soundness of the banking system is broadly improving in the last few years, following the Bank of Sudan comprehensive banking policy, which includes structural and financial soundness reforms and deepening of banking technology and Islamization in the banking system.

¹¹⁵ Tarik Yousef, 1996, *op. cit.*

¹¹⁶ Bank of Sudan, 2001, *Annual Reports*, Sudan.

The Bank of Sudan annually sets the objectives of financing policies, and rules governing extension of banking finance, as well as liquidity management through setting and monitoring quantitative monetary targets such as *Murabaha* margins, customers' share in *Musharaka* and administrative margins under *Murabaha* contract. Moreover, statutory reserve requirements and financing window requirements are also set.

The monetary policy of the Central Bank of Sudan (CBS), (called the financing policy)¹¹⁷ and its control instrument represents a unique one, as it reflects the experience of full Islamization of the banking system. Until the late 1990s, apart from credit ceilings and required reserve policies, the BOS used quantitative and qualitative credit control through *Musharaka* rates and minimum *Murabaha* margins (minimum percentage of profits from *Murabaha* financing), but without considerable effects on overall and sectoral financing facilities. During the period 1990-1996 the CBO issued detailed directives of discriminating profit and loss ratios as well as minimum contribution of clients under *Musharaka* contracts, and discriminating minimum mark-up rates under *Murabaha* contracts. Since 1990, *Musharaka* ratio was eliminated and was left for the banks to determine. Discriminatory minimum mark-up for *Murabaha* varied between 36 and 48% until 1998. Since then they have been substantially reduced and unified at 36%, 20% in 1999, 18% in 2000 and only at 10% in 2001. The CBS also annually announces combined credit ceilings for what is called "priority sectors", (Craftsmen, Professionals and Small Producers including Productive Families, Agricultural Sector, Industrial Sector, Export Sector, Mining and Energy Production Sector, Co-Operatives, Investment in Shares, Cultural and Media Production, Private Sector Investment in Rural Services, Low Cost Housing Sector, Transport and Storage Sector). Financing to priority sector share reached 95% of the total banking finance in 1998, reduced to 90% in 2000 and 2001. Almost half of this volume of finance is earmarked for the agricultural sector as stipulated by the financing policies of the BOS. The required reserve policy has also been used by the BOS as a tool of monetary control. The ratio underwent many changes up and down since 1989. In 1989 it was 18%, raised to 20 % in 1990, and 30% in 1993, then reduced to 26% in 1997 and to 15% in 2001. Other instruments are Margins of Letters of Credit, foreign exchange transactions and directives in inter-bank lending¹¹⁸.

Until 1990, the policy instruments of the Bank of Sudan were limited. Some new instruments were announced in 1998 with the hope of introducing indirect liquidity management tools. In 1998 the CBS had introduced *Shariaa*' compatible new instruments of indirect second-generation financial instruments of policy and liquidity management, as well as modifying the existing ones to strengthen monetary mechanism. Moreover, the banking system in Sudan has undergone substantial liberalization, privatization and restructuring and increase in bank capital and strengthened its supervision. Moreover, the Bank of Sudan has been active in the last few years in strengthening prudential supervision and reforming the banking system, tightening the banks' large share of non-performing loans, enhancing profitability, restructuring of banks and increasing the banks' capital, restructuring the loans portfolio, and addressing the difficulties facing them.

¹¹⁷ In the non-interest-based Islamic system there is no loans as in the conventional system, and the Islamic system extend finance mainly of profit and loss sharing or sales bases.

¹¹⁸ Bank of Sudan, *Annual Reports*, different issues.

Assessing the Role of Sudanese Islamic Banks in Economic and Social Development

Geographical Distribution

SIBs are characterized not only by the declining number of branches but also by the regional inequality in the distribution of branches i.e. concentration of branches in commercial towns and urban areas. From the Table (1) below it may be made clear that Khartoum State and the Central States (the most advanced States in terms of development projects, infrastructure, per capita income and the standards of living) share over 50% of the total banks in the country. If we include the Eastern and Northern States the ratio rises to nearly 80%. Moreover, the pattern of distribution has been more or less the same for the last five years or so. Another feature is the declining number of branches from over 700 in 1997 to only 533 branches in 2002.

Table (1): Distribution of bank branches.

States	1997	1998	1999	2000	2001	2002	Average
Khartoum State.	222 (31.5)	223 (31.8)	208 (32.4)	210 (33)	199 (34)	182 (34)	207 (32.8)
Central States	161 (22.8)	166 (23.7)	149 (23.2)	138 (22)	126 (22)	108 (20)	141 (22.3)
Eastern States	99 (14.0)	93 (13.3)	92 (14.3)	86 (14)	77 (13)	73 (14)	87 (13.8)
Northern States	86 (5.1)	79 (11.3)	79 (12.3)	71 (11)	63 (11)	59 (11)	73 (10.3)
Kordofan States	62 (8.9)	64 (9.1)	53 (8.2)	58 (9)	55 (10)	53 (10)	58 (9.2)
Darfur States	52 (7.4)	56 (7.8)	44 (6.8)	49 (8)	43 (7)	41 (8)	48 (7.5)
Southern States	23 (3.3)	21 (3.0)	18 (2.8)	16 (3)	18 (3)	17 (3)	19 (3.0)
Total	705	702	643	628	581	533	562

Sources: Calculated from the BOS Annual Reports, different issues.

Figures in parenthesis are percentage share of each state out of total branches.

The same pattern of regional inequality of distribution of branches had been the characteristics of the Sudanese banking system even before the full Islamization in Banking in the late 1980s. In his comparative study of Fiasal Islamic bank and other commercial banks before Islamization, Ibrahim had cited percentages of the degree of banking concentration between 1979 and 1987 to be 38.9% for Khartoum, 17.5% for central region, 12.7% for Eastern region, 4.9% for Northern region, 11.9% for Kordofan region, 5.6% for Darfur region and 8.7% for the Southern Region.¹¹⁹ It is worth noting that the less developed Kordofan and Southern regions are currently sharing less of banking branches compared with during the late 1980s. This distorted geographical distribution of banking facilities cannot serve socio-economic development, particularly in rural areas.

Short vs. Long-Term Deposits/ Investment

Table (2) below shows current, saving and investment deposits of the SIBs. The short-term (current account deposits) versus long-term (saving and investment) deposits is still almost evenly

119 Ibrahim, Badr-El-Din, A., 1992, 'Some Aspects of Islamic Banking in the Least Developed Arab Countries: Reflections on Faisal Islamic Bank, Sudan', a Paper published in Rajfer, Kamibert and Saleh Mohammed (eds.) (1992), *The Least Developed and the Oil-Rich Arab Countries: Dependence, Interdependence or Patronage*, St. Martin Press, London, United Kingdom, p. 225.

distributed, despite the high growth rate of saving and investment deposits compared with current deposits. This is because historically the share of current account deposits is larger.

Table (2): Sudanese commercial banks' deposits by type

Description / years	1997	1998	1999	2000	2001	2002	Average
Current Deposits	48387	47168	59295	87203	112857	151134	-
%	(71.4)	(39.3)	(46.5)	(44.2)	(41.2)	(41.6)	(47.4)
Growth rate	-	(-2.5)	(25.7)	(47.1)	(29.4)	(33.9)	(26.7)
Saving & investment	19206	72944	86224	110021	161331	211940	-
%	(28.3)	(60.9)	(53.5)	(55.8)	(58.8)	(58.4)	(52.6)
Growth rate	-	(279.8)	(18.2)	(27.6)	(46.6)	(31.4)	(80.7)
total	67793	120112	127519	197224	274188	363074	-

SIBs normally prefer demand deposits which do not share profits with them, and few Islamic banks (ISBs) are hunting to attract investment deposits. Studies depict some observations about shortages of long-term funds in Islamic banks. More than 10 years ago Ibrahim, 1992, for example, noted that during the period 1988-1992 Faisal Islamic Bank of Sudan (FIB) had shortages of medium and long-term funds. He concluded that the introduction of FIB has not improved the deposit situation in the Sudanese banking system at that time. A shortage in deposits of ISBs has also been noted by Al-Harran. Al-Harran concluded that: "... if they (the Islamic banks) do not devise non-usurious tools of raising (investment) deposits, then these banks are likely to face problems in their growth particularly when they are working side by side with the modern banks"¹²⁰ (emphasis between two brackets is added).

Credit by Modes of Finance

Table (3): Credit flow by modes of finance.

Modes of finance	1996	1997	1998	1999	2000	2001	2002	Average
<i>Murabaha</i>	53	52	54.3	36.2	33.7	39.5	35.9	43.5
<i>Salam</i>	4	8.4	6.5	5.1	3.4	5.0	3.3	5.1
<i>Mushrarka</i>	32	22.6	21.1	30.8	42.9	31.0	27.9	29.8
<i>Mudaraba</i>	2	5.4	6.1	4.1	3.5	6.2	4.6	4.6
others	9	11.6	12.0	10.9	16.5	18.3	28.3	15.2
total	100	100	100	100	100	100	100	100

According to Table (3) above, on an average, sales-based modes of finance (*Murabaha* and *Salam*) share nearly 50% of total volume of finance of ISBs in Sudan. While profit and loss-sharing formulae (*Musharaka* and *Mudaraba*) share around 34%. ISBs do not usually focus on *Musharaka* and *Mudaraba* in financing clients. The share of partnership modes of financing in Sudan, although not satisfactory, are, nevertheless, better than the general trends of ISBs in which these formulae constitute about one-fourth of the asset portfolio of the world-wide Islamic banks.¹²¹ Tarik has cited different percentages for the period of 1980s and 1990s. He showed that the share of the profit and loss sharing techniques were in the range of 33-38% for Iranian banks (which, like Sudan, applies full Islamization of the banking system) and in the range of only 7-8% for banks in mixed financial sectors during the period 1981-1993¹²². While the mark-up techniques shared around 51-60% for

¹²⁰ Al-Harran, Saad, 1993, *Islamic Finance: Partnership Financing*, Pelanduck Publications, and Malaysia, pp. 107-109).

¹²¹ Shapra, Umar, 2001, "Strengthening Islamic banks", a paper presented to the seminar on: Regulation and Supervision of Islamic Banks: Current Status and Perspective Developments, Islamic Development Bank, The High Institute for Banking and Financial Studies, Khartoum, 24-26 April, p. 4.

¹²² Based on 22 banks in 13 countries with mixed banking system.

Iranian banks and they are in the range of 83-90% for banks in the mixed financial sectors in other countries over the same period¹²³. Sales-based modes of finance are neither suitable modes for financing for long-term projects nor for social-oriented projects.

Although profit and loss (PLS) modes conform to the real Islamic system of finance, which stand contrary to interest-bearing traditional system they are, nevertheless, not free from application complications. Al-Harran (1993, p. 150) identified that risk, difficult nature of investment and long-gestation period in receiving returns and problems of management are the major reasons why Islamic banks do not undertake equity financing modes. PLS modes require adequate experience in management, additional supervisory and monitoring roles compared with sales-based modes, which are relatively less risky and easy to manage¹²⁴. Moreover, PLS modes are subject to erosion of investment in the case of a loss that is why ISBs are hesitant to undertake them at the initial phases of their operations. Instead they use mostly debt-based *Salam and Murabaha* instruments, which shift most of the risk to the client. The bank of Sudan Annual Report of 2001 admitted that the substantial use of *Murabaha* mode of finance in the Sudanese banking system is due to "the simplicity of this mode and the people's preference"¹²⁵.

4.4. Sectoral Distribution of Financing

The sectoral distribution of banking finance in Sudan can be seen from the following table.

Table (4): Sudanese Commercial banks finance by economic activities (%)

Sectors	1994	1995	1996	1997	1998	1999	2000	2001	2002	Aver.
Agriculture	29.3	24.7	26.5	35.5	33.3	30	22.5	17.6	14.3	26.0
Industry	18.3	18.0	18.8	17.8	18.8	15	10.5	14.8	13.0	16.1
Exports	22.2	27.1	19.6	20.4	17.1	17	21.2	15.7	13.7	19.3
Imports	1.1	8.5	5	2.1	0.7	3	1.4	3.7	4.4	3.3
Local trade	5.6	2.9	3.6	4.2	4.3	6	10.4	18.8	22.6	8.7
Others	23.5	18.8	26.5	25	25.8	29	33.9	29.2	32.0	27.1
Total	100	100	100	100	100	100	100	100	100	100
Annual rate of growth	(91.0)	(44.1)	(133.9)	(22.0)	(14.0)	(2.8)	(62.6)	(40.6)	(43.7)	(51.4)

The annual rate of growth of financing by the SIBs is high as more than 50% on an average. This increase in financing is not evenly distributed among sectors. Sectoral concentration of investment is biased towards the most organized sections with high profitability in the modern sector. Agriculture and industry share 42.1% of the total banking finance. Trade-related financing (exports, imports and local trade) shares over 31.3%. Moreover, the analysis of sectoral lending in 1993 shows that about 74 per cent of the combined total lending of commercial banks was directed towards modern agriculture, industry and exports. Small producers shared only 6 per cent of the total lending¹²⁶. Likewise, Tarik has shown some sharp unequal sectoral distribution of Iranian and other banks in mixed financial sectors¹²⁷. The sectoral distribution of finance during the period

¹²³ Tarik, Yousef, 1996, *op. cit.*

¹²⁴ The same applies to the sales-based modes the agricultural-based *Salam* mode of finance may be riskier than *Murabaha* that is why it share in the banking system of Sudan is only around 5%.

¹²⁵ Bank of Sudan, 2001, *Op. cit.*, p. 55.

¹²⁶ El-Tigani Saïd, et al. 1995. 'Financing Small and Medium Enterprises: The Sudanese Experience'. Presented to the *Workshop on Financing Small and Medium Enterprises in the Arab World*, Union of Arab Banks and Nelson Industrial Development Bank Group (NIDBG), 19-21 December, 1995, p. 18.

¹²⁷ In their attempt to secure liquidity during the 1980s and 1990s Islamic banks depends on short-term trading financing via *Murabaha* mode. They, nevertheless, continued to use this formula thereafter.

1984-1992 favours trade and commerce (82.1%), while agricultural share is only 7.2% and the real estate's share is 10.5%.¹²⁸ These led Tarik to conclude that: "*The emerging corpus of facts about the operations of Islamic banks over the last two decades sheds serious doubt on their ability to perform this role (channeling financial resources into long-term investment projects in productive sectors of the economy on the basis of equity) which is vital for economic growth*".¹²⁹ (emphasis between two brackets are added).

SIBs usually do not present data relating to the distribution of finance as short, medium and long-term. But, nevertheless, because of inflation, most of the finance, even for agriculture and industry (via provision of raw materials, fixed assets, working capital, irrigation, inputs, storage, transport and marketing, land preparations etc) is Short Term for a period of maximum one year mainly through *Murabaha and Salam*. These two modes of finance are suitable for financing short-term projects. Tarik Yousef, on the other hand, showed some evidence indicating that Islamic banks financing is rarely extended on a long-term basis: and short-term lending dominates overall. ISBs distribution of finance during the period 1984-1992 was 75.4% short term, 5.4% medium term, 2.1% long term and real estate financing shared 15.4%¹³⁰. If Islamic banks are not able to generate long-term sizable deposits, they will not be able to extend long-term loans that are deemed necessary to achieve developmental goals.

Poverty Alleviation

Poverty in Sudan is wide to the extent that incomes cover only a fraction of the cost of living, caused by relatively low incomes, inequality in its distribution and the continuous rise in the prices of goods and services. The degree of poverty in Sudan has been measured to be 82.7 per cent and 83.1 per cent for rural and urban populations respectively¹³¹. The Head Count Index (the number of poor living under the poverty line) showed that poverty exceeds 90 per cent, and between 1990 and 1996, the number of poor increased by 2.5 per cent annually¹³². Given this wide range in poverty, the question arises as to what the Sudanese Islamic banking system offers to alleviate poverty as part of its social and economic development?

In order to have some idea about the Islamic banking finance to alleviate poverty we may perform the following exercise.

Detailed statistics on sectoral distribution of financing are not readily available. Only the breakdown of the financing made by the Saving and Social Development (SSD) bank, is available. The SSD bank, according to its objectives, is a poverty-oriented Islamic bank. The share of SSD bank in total commercial banks' loans in 2001 is only 2.4%, and the share of the bank's loans allocated for "poverty-oriented" sectors namely, crafts, household, small producers and social development is 16.5%¹³³. It is believed that the SSD bank is the first ranked bank in alleviating poverty in Sudan. Although, it is unrealistic to apply the same ratio of financing poverty-alleviation sectors of the SSD bank to whole commercial banks in Sudan, but it might prove useful to have an idea about the total poverty-alleviation financing of the banking system in Sudan if they follow the

¹²⁸ Tarik, Yousef, 1996, *op. cit.*

¹²⁹ Tarik, Yousef, 1996, *op. cit.*

¹³⁰ Tarik, Yousef, 1996, *op. cit.*

¹³¹ Nour, Tahir, Mohammed (1996), "Poverty in Sudan and the role of Saving and Social Development Bank", unpublished paper.

¹³² Seminar on poverty, June 1997, Ministry of Social Planning, Sudan, and the UNDP.

¹³³ Bank of Sudan, 2001, *Op. cit.*, Bank of Sudan, Khartoum.

same trend. Given that the total commercial banks' loans were SD 146381.9 millions in 2001, then the poverty alleviation share (finance to crafts, households, small producers and social development) is only SD 24153 millions. This share constitutes only 0.7% of GDP in 2001.

In fact, Sudanese banking finance cannot be considered effective for poverty mitigation, as its performance and banking indicators are poor. The following table (Table 5) summarizes financial and performance indicators of the Sudanese Banking system during 1998-2002.

Table (5): Financial and performance indicators of SIBs.

Description/Years	1998	1999	2000	2001	2002
Public Expenditure/GDP (%)	11.4	8.9	12.4	12.8	10.8
GDP nominal growth rates (%)	Na	22.9	21.2	13.8	3.0
Demand Deposits (SDD millions)	54881	62752	93505	117551	na
Growth rate of demand deposits (%)	Na	14.3	49	25.7	na
Total deposits/GDP (%)	6.0	5.9	6.6	8.2	10.6
Total deposits/M2 ratio (%)	60	58	59	64	na
M2-Currency/GDP (%)	6.3	10.5	6.9	8.2	na
Credit/GDP (%)	3.4	4.3	2.4	3.0	na
Non-performing loans/total loans (%)	Na	na	17	16	12.7
Velocity (GDP/M2), (%)	9.6	9.5	8.7	7.8	6.2
Total assets/GDP (%)	16.0	17.4	12.0	13.5	11.3
Liquid assets / total deposits (%)	26	1	28.9	20.9	na
Loans / total assets (%)	14	11	22	24.5	na
Total deposits / total liabilities (%)	37	35	55	60.2	na
Loans -to- deposits ratio (%)	37	35	40.2	40.6	na
Capital adequacy ratio	na	na	7	11	9
Ratio of loan provisions to bad loans	na	na	29	23	24

Source: Calculated from figures obtained from the Central Bank of Sudan, Annual Reports, different issues; IMF, Country Report, No. 03/390, 2003.

From the Table (5) above, the following conclusions about the overall performance of the banking system in Sudan, that has bearing on the developmental objectives, can be reached:

1. The reasonably high growth in the volume of demand deposits (related partly to the high nominal GDP growth rate), the sizable fall in inflation rates in recent years, and the increase in the ratio of total deposit -to- GDP over the last years signal a stable confidence in the banking system.
2. The low ratio of public spending to GDP and the low ratio of broad money- currency-to-GDP (around 6-10%) reflects the weak size of the financial sector and weak financial liquidity and financial depth of the Sudanese banking system.
3. The low ratio of credit to GDP (2-4%) reflects the difficulties ISBs in Sudan are facing providing funds for development.
4. Non-performing loans-to total loans reached 17% in 2000, and there is a declining trend thereafter. This reflects poor credit performance and defaults of big clients.
5. Loan-to-deposits ratio provides a measure of risk taking as demonstrated by the degree to which resources are extended. It gives an indication of the ability of the banking system to mobilize deposits to meet credit demand. In Sudan, the ratio of loans to deposits (around 40%) indicates no pressure on the whole banking system, and a high level of liquidity to respond to shocks. But the low ratio also reflects weak inflow of financial resources into the development process of the country.
6. The low and declining ratio of total assets-to-GDP and liquid assets to total assets reflects the weak financial base of the Sudanese banking system.

Current Economic Wisdom Versus Shari'aa Rules

Harmonization of *Shari'aa* rules with the current economic thinking to cope with today's modern and global world development constraints and to create 'real' integrated Islamic financial institutions has been a challenge to ISBs, not only in Sudan but also elsewhere. This lack of harmonization assumes two forms:

First: Internal monitoring of banks in Sudan is confined to minority of shareholders. The *Shari'aa* Monitoring Boards are formed by bank managers who select and remunerate their members, that is why they seldom reverse the management decision. The same applies for *Shari'aa* Monitoring Boards of the Central Bank of Sudan¹³⁴.

Second: the conflict that may arise between ancient *fiqh* opinions and the modern practice of Islamic banks.

Islamic banks's Development Role and Globalization

Globalisation drive and information technological development accelerates the development of the banking industries in many ways among them is banking amalgamations to have more market shares, acceleration of banking operations, development of new banking products, and the opening of Islamic avenues in the international banking arena that would increase competition with Islamic banks.

Globalization set challenges to Islamic banks through two ways:

Social effects of globalisation:

No doubt the current globalisation creates more international wealth, but it also creates unbalanced outcome, both between and within countries. Too many countries and people are not sharing the benefits reaped by the new wealth created by globalisation. That is to say this reflects the social dimension of globalisation. We agree with the recent ILO Report that responses to globalisation have to come from within. The Report stated that that: "...How (people) managed their internal affairs influences the extent to which people will benefit from globalisation and to be protected from its negative effects. In this important sense the response to globalisation can be said to begin at home".¹³⁵ (Emphasis between twobrackets is added).

Banking effects of globalisation:

Globalisation sets a challenge to Islamic banks in four aspects:

- a. Liberation of banking operations.
- b. Reduction of the operational costs and improvement of banking technology via amalgamation and the use of large-scale economies.
- c. Modernization and diversification of banking activities, derivatives, incomes, risks and liquidity;
- d. The move towards integrated banking practices through the use of the advanced technology and provision of services at competitive costs.

¹³⁴ Awad, Mohammed, Hashim, 2001, "Commentary on D. T. Llewellyn's paper: A regulatory regime for conventional and Islamic banks", a paper resented to the seminar on: Regulation and Supervision of Islamic Banks: Current Status and Perspective Developments, Islamic Development Bank, the high Institute for Banking and Financial Studies, Khartoum, 24-26 April.

¹³⁵ A Fair Globalisation: Creating Opportunities for all, 2004, ILO World Commission on the Social Dimension of Globalisation, ILO Geneva, p. xi.

These challenges must not overlook the national and community roles Islamic banks should play in economic development. We believe that proper Islamic financing implementation that caters for social development within the country is a shelter against negative globalisation effects.

Conclusion & Policy Recommendations

From the above analysis we can deduce the following conclusions:

1. Many banking indicators in Sudan (such as low ratio of spending to GDP, low ratio of M2 to GDP, low ratio of credit to GDP, high ratio of NPL to total loans, low ratio of asset to GDP and liquid assets to total assets) are signs of weak size of financial sector and financial liquidity, low confidence in the banking system, and low and poor credit performance. The good signs came from deposits (stagnation of the ratio of total deposit to GDP, and high growth of deposits), and a sizable fall in inflation rates in recent years.
2. Apart from factors like operational simplicity, low risks and clients' preferences; sales modes are dominant in SIBs. Although sales-based modes (purchase, sale or lease transactions) are permissible by *Shrai'aa* law, they are not suitable modes to realize the full socio-benefits of Islamic system of financial intermediaries. The realization of social objectives cannot be attained until PLS modes substantially rise in total financing.
3. Concentration of branches in commercial towns and urban areas, and the depressed areas are sharing less percentage of banking branches over time.
4. High share of demand deposits and shortages of long-term funds in Islamic banks.
5. Sectoral concentration of investment is not evenly distributed and is biased towards the modern most profitable sectors, including trade, modern agriculture, and industry.
6. Although there is no available information about short and long term distribution of investment, it is believed that a sizeable portion of the finance (because of inflation) is short term of less than one year.

The developmental role of Islamic banks needs to entwine economic development with social development and must use investment modes to provide basic needs according to the capabilities and needs of each country. Islamic banking, if properly understood, and fully practised, will address those income distribution and poverty alleviation issues where capitalism has failed. Social awareness and moral concern in Islamic development thinking require that production priorities should be geared towards common needs of the people, and emphasis on the people in development through specialised branches or through the creation of a suitable mechanism to reduce the cost of lending, increase profitability and enhance the volume of lending, especially small amount lending to poor people in rural areas. In seeking a social role for the Islamic banks, there are many issues which need to be addressed properly. Can all the peoples' requirements of today be considered ethical requirements?

SIBs need to devise investment plans for short and long term period in sectors according to development and social priority needs. They should also play a major development role employing heavy use of partnership financing (which is more development-oriented) than sales-based formulae (which are commercially-oriented). They must have a moral obligation towards alleviating poverty as a developmental priority within their capabilities. Economic development should not be limited to a narrow sense, and should embrace social development as well.

The process of development requires the renewal of *fiqh* in the course of *Ijtihad* to devise new rules which have not been implemented by ancient scholars, or to change rules in accordance with the current economic problems brought about by globalisation (*tajdeed*). We also need to create some sort of harmonization of economic and *fiqh* thinking in the face of recent development of economic realities. In particular, we need to be more flexible when we deal with the current economic development and realities. This requires new research in Islamic banking coupled with the renewal of Islamic thinking taking into consideration the new worldwide developments. Although Islamic banks have long been created, Islamic banking scholars are still struggling to define an Islamic economic system, and there exists little consensus on how the Islamic banking should behave in practice to achieve economic and social development within the current globalisation and international economic order. This needs further research.

To cope with the changing economic environment and to harmonize *fiqh* and economic thinking, we call for smoothening the way for further development-oriented Islamic banking system. Specifically we need to develop, modernize, and create kind of self-governing *fiqh* supervision. Their *fatwa* should be binding and their staff structure should include both economists and scholars, should not be confined to one *Mazhab* and should open wider avenues to *Ijtihad*.

Business Session : 6

20th December 2004, Monday, 3.00 P.M.~5.00 P.M.

SOCIAL ACCOUNTING AND ISLAMIC INSURANCE

KEYNOTE LECTURE

Professor Sofyan S. Harahap

Department of Economics & Postgraduate Program in Islamic
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Masudul A. Choudhury, UCCB

&

Dr. Yuswar Basri

Social accounting in Islamic political economy

Professor Dr. Abu Bakr Rafique

Pro-Vice Chancellor

International Islamic University Chittagong, Bangladesh.

Insurance: an Islamic paradigm

Dinner-Keynote Lecture

20th December 2004, Monday, 8.00 P.M.

Mr. Rodney Shakespeare

Global Justice Movement of Global Talk

London, England.

Islamic endogenous loans

SOCIAL ACCOUNTING IN ISLAMIC POLITICAL ECONOMY

*Professor Dr. Masudul Alam Choudhury**

*Professor Dr. Sofyan S. Harahap***

ABSTRACT

The *Tawhidi* (oneness of Allah = unity of divine knowledge) epistemological background is invoked as a general ethico-economic paradigm establishing and explaining pervasive complementarities by the process of learning between the elements of any socio-scientific system. Within this general ethico-economic systemic framework the topic of interactive learning by relational epistemology of social accounting, economics and management is examined. The analytical and institutional dimensions of the resulting interactive, integrative and evolutionary (IIE = *Shuratic*) process methodology are formalized. Such an IIE-process model is exemplified by the Islamic political economy of development in which social accounting, management and economics are made to co-determine the total socio-economic development process. Necessary policy directions for carrying the implications of the paper further are pointed out.

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SOCIAL ACCOUNTING IN ISLAMIC POLITICAL ECONOMY

Our objective in this paper is to apply the *Tawhidi* (unity of divine knowledge) methodology of Islamic political economy as a paradigm of unity of knowledge and systems derived from the epistemology of *Tawhid* in relation to pervasively complemented systems. An example of the issue of application for this paper is social accounting in relation to management and economics. We will show how the structure of social accounting takes its roots in the *Tawhidi* epistemology of pervasive complementarities between ethical and measured variables of the accounting, institutional and socio-economic systems. In this way this paper is expected to contribute to the extensive nature of the *Tawhidi* methodology of unity of knowledge characterized by the framework of the principle of pervasive complementarities.

This paper is in three parts. The first part builds up the *Tawhidi* epistemological methodology as a general systems approach of unity of knowledge within systems as guided by the indispensable premise of the divine law. The second part applies this methodology to the case of social accounting, where the measured variables in the light of the moral and ethical values of the Shari'ah are shown as being endogenously interwoven in a nexus of systemic dynamics between social accounting, management and economics. The third part of the paper is a conclusion that summarizes the salient features of Islamic social accounting in respect to the integration of measured variables with ethical and moral values for both evaluation of an accounting entity as well as for policy making. By combining these three parts of the paper, the study becomes one in a general ethico-economic approach for investigating systemic unity of knowledge that invokes *Tawhidi* epistemology. Such an ethico-economic general equilibrium methodology provides the delineation of the field of Islamic political economy and world-system.

Islamic Political Economy and World-System

The study of Islamic political economy and world-system comprises an epistemological examination of socio-scientific phenomena in the light of the pervasively interactive worldview presented in the *Qur'an* (Choudhury 1992a, 1995a, 1997a, 1997b, 1997c, 1997d, Choudhury et al 1992). The social rules and actions of agents (*Ahkam*) in accordance with the *Qur'anic* holistic worldview are then operationalised by the guidance of the Prophet Muhammad (*Sunnah*). The human discursions involving the *Qur'an* and the *Sunnah* are taken up in the midst of pervasive interactions that comprise the institution of the *Shura*. The *Shura* as a universally interactive and hence consultative order generates a *process*. This process leads from interaction to social consensus (or majority agreement) called *Ijma*. We will also call the joint process of interaction and consensus as the interactive-integrative phase of the *Shuratic* process.

From every state of *Ijma* evolve new rounds of interaction followed by new integration and new evolution of similar types of circular causation between knowledge-flows systemically generated and their interactive-integrative influence on the systemic entities. In the end, the *Shuratic* process becomes a combination of the interactive, integrative and evolutionary process of knowledge formation and learning in world-systems. We call this knowledge-inducing process equivalently as the *Shuratic* process or the interactive-integrative-evolutionary (IIE) phase of the *Shuratic* process. The IIE-process is indeed the complete delineation of the continual dynamics of circular causation that takes place over all newly emergent and continuing phases of the past and future history of the *Shuratic* process.

Fundamental in such phases or circular causation rounds of the *Shuratic* process or the interactive-integrative-evolutionary process (IIE-process) is the unifying outlook of the universe and its sub-systems. Such a pervasive and universally systemic understanding of the *Shuratic* process is derived directly from the *Qur'an* (Ch. 42, verses 49, 51-3). The unifying worldview is derived from

the epistemology and ontology of the divine law at work in the world-systems as they are created, guided and sustained by the human guidance by and understanding of the divine law (*Sunnat Allah*).

The *Shuratic* expression is regenerated in the real world by knowledge-flows signified by interaction leading to unification (integration) and the enhancement of interaction-integration over new rounds of knowledge (evolution). Such IIE-processes appear as learned participation between the knowledge-flows emanating by the divine will and the realization of their impact and regeneration from the evidences and entities of the world-systems. Such a relational epistemology understood conterminously as premise and experience, appearing and renewing over the dynamically creative IIE-process is explained in the *Qur'an* as the emanation of the results of learning by *Tasbih* (consciousness) between the episteme of unity of knowledge and the entities and relations of world-systems. Such an IIE-process is pervasively participatory as it is encapsulated within the grand and embryonic *Shuratic* processes of learning, emanation and continuity.

Hence we obtain the conjoint action and responses between *Tasbih* and the *Shuratic* process as so understood in the pervasively participatory and embryonic sense of unity of knowledge in the world-systems. We thus have the epistemology of Divine Oneness and the unification process of knowledge-flows emanating from the action of the divine law on the world-systems. The epistemology of Divine Oneness remains exogenous but is ever present in all sub-systems qualified by extensive *interrelationships*, i.e. in all processes explained by relational epistemology and ontology of systemic unity of knowledge as derived from the divine law. We refer to the fundamental epistemology of Oneness (*Tawhid*) as the Stock of Knowledge by virtue of its completeness and absoluteness in the total creative frame of all world-systems.

Unification caused by knowledge-flows within and across all systems and processes causing IIE-phenomenon to appear and expand is endogenous in nature. Hence all socio-economic variables, instruments, institutions, preferences and behaviour induced by the knowledge-flows causing unification of systems, relations and processes to occur, become endogenously interrelated. The measurements around such activities are also thereby induced by the knowledge-flows emanating from the fundamental epistemology of *Tawhid*.

The Underlying *Tawhidi* Precepts and Assumptions of Islamic Political Economy

Certain fundamental precepts of the *Tawhidi* methodology lead the way for the understanding of Islamic political economy and world-systems. Within such a configuration of IPE & WS our Social Accounting system will be encapsulated along with its interactive parts, namely Economics and Management.

We formalize here a simple case of the *Shuratic* process (IIE-process). Embedded in this formalization is the endogenous general equilibrium ethico-economic formalism of Islamic political economy and world-system. The relations established on the premise of the *Tawhidi* epistemology and its ontological world-system constructions are endogenous and knowledge-induced within the *Tasbih-Shuratic* complementary perspective. Such formalism explains the nature of learning in and across world-systems in the IIE-process. The same formalism also leads to the development of quantitative interrelations that configure the circular causation formalism of the IIE-process in terms of empirical facts.

As a natural consequence of the embedded circular causation of the *Tasbih-Shuratic* interrelations arises the cardinal Principle of Pervasive (or Universal) Complementarities. This principle is

derived from the *Qur'anic* rule of creation in pairs. The pairing between the good things is of the nature of unity of knowledge sharing. Pairing between the bad things (falsehood) leads to internal dissensions, conflict and competition and thereby leads to unsustainability of such a system. The principle of pervasive complementarities explains how pervasive *inter*-linkages are formed between knowledge and their induced entities and variables, and thereby, how such *inter*-linkages continue to reinforce the process of unification of knowledge.

In the *Tawhidi* methodological formalism of unity of knowledge we show how socio-scientific analysis and inference are organized in the endogenous system of complementarities (IIE-process). This involves formulation of a knowledge-induced simulative design of circular causation between the entities, variables and relations *inter*- and *intra*- systems.

With the above precepts acting in concert with each other, Islamic political economy and world-system becomes the study of the *Shuratic* process or the IIE-process interlinking the economy with institutions, polity, society and science. The agency of decision-making at all levels is taken up in the light of knowledge-induced *inter*-linkages acting and responding in the *Tasbih-Shura* mode.

Islamic political economy is thus a study of systems of endogenous socio-scientific *inter*-relationships governed by the principle of pervasive complementarities as the explanatory basis of unification of knowledge, that is the *Qur'anic* pairing of creation (Choudhury 1994a). The interrelations that emanate and continue between knowledge and their induced entities are of the nature of circular causation. That is, every part of the system is circularly related with another across circular flows of the relational epistemology inverting with ontology of the world-system over phases of the IIE-processes taken *intra*- and *inter*- systems.

The continuum of the IIE-processes over repetitive phases of the circular causation ends only in the Hereafter (*Akhira*) as the Great Event (*Naba ul Azim*) of the closure and optimality of knowledge. The IIE-processes, equivalently the *Tasbih-Shuratic* processes of unity of knowledge and the world-systems are everywhere open but acquire dynamically evolutionary equilibriums under the force of relational epistemology in the context of the closure of the large-scale universe spanning the following complete domain:

$$\Omega \rightarrow \text{Spanning all World-Systems [knowledge and falsehood]} \rightarrow \Pi = \Omega \quad (1)$$

denotes the topology of the *Tawhidi* Stock of Knowledge.

The methodology of the *Shuratic* process or the IIE-model as encapsulated in expression (1) hinges on the following critical factors. Similar methodological orientation has given by Sztompka (1992) in the study of social transformation but without the epistemology of oneness. Rather the reduction to human nature is endemic in such a theory.

First is the epistemology of *Tawhid* that is of the Oneness of Allah in the sense of the Absolute and Complete Stock of Divine Knowledge. Secondly, knowledge-flows emanate from the Stock and bring about unification between all knowledge-induced forms across world-systems. Thirdly, such a unification of knowledge carries the prototype of unity of the Stock and thus complements sub-systems. Fourthly, universal complementarities occur by the process of interaction leading to integration followed by creative evolution to higher planes of knowledge and learning. Fifth, knowledge-flows appear in their creative form in perpetuity until the Hereafter. Hence, optimisation and steady-state equilibrium methods are necessarily replaced by simulation methods across domains of knowledge-flows and their knowledge-induced forms. Sixth, the permanent completion and closure of the knowledge-induced *Tawhidi* world-systems is realized *only* at the Event of the Hereafter (*Akhira*). This is the Event of accumulation of all kinds of systemic

$\{x_i(i)\} = \{f_i(\{i\})\}$ is the set of knowledge-induced experiential forms appearing during rounds of interaction I . The set of interactions leads to a social consensus (*Ijma*). Clearly, $\{x_i(i)\}$ are premised on the E-episteme.

We now have the wellbeing (*Falah*) criterion generated by the knowledge-induced tuple, $\{i, x_i(i)|A\}$, meaning that A induces the tuple as a whole. From now on 'A' will be implied, and we will suppress the $[A]$ term.

The *social well-being function* is given by, $SW = SW(i, x_i(i))$. $SW(\cdot)$ is post-evaluated jointly by interaction of the preferences of polity and the ethicised preferences of agents in and through the market order, the socio-scientific order and the like. These agents are induced by the knowledge forming process, as shown in expressions (1) and (2). Thus, such interactive preferences are continuously simulated by knowledge-flows appearing as interaction leading to integration, and thereby to creative evolution of the knowledge-world-system circular interrelationship. The agents and agency specifically configuring the variables are denoted by $\{x_i(i)\}$. Note that for the sake of simplicity we have suppressed many of the subscripts that should go with the i -variable to signify agents, interaction, systems, variables, their *interrelations* etc.

At the point of post-evaluation of $SW(\cdot)$ in terms of $\{i, x_i(i)\}$, creative evolution of similar 'processual' orders arise. Thus, interactions lead to integration within a set of interaction-integration denoted by I , and thereafter to evolution. The IIE-process model is now signified by the emergence of the new knowledge-flows $\{i_2\}$. The sequences of tuples, $\{i, x_i(i)\}$ and their social wellbeing criteria denoted by $SW_i(i, x_i(i))$, continue on along the *Shuratic* or the IIE-string as shown by the TSR.

The TSR denoted by expression (2) describes how the divine law of Oneness is simulated in the framework of IIE to establish extensively complementary *interrelations* in the experiential world-system by means of knowledge-flows. Since all inputs and outputs of this system are knowledge-induced, therefore, systemic 'universal complementarities' are established in this systems-order by means of endogenously regenerating knowledge-flows and the world-systems entities, variables and their relations.

The f 's and g 's called *Ahkam* (rules derived from the divine law) denote the derivation of rules and guidance from the E-episteme. The sequences, $P_i = (\{i\} \rightarrow \{x_i\} \rightarrow \{i_{i+1}\})$, $i = 1, 2, \dots$, shown in the TSR (2) comprise phases of the *Tasbih-Shura* process in continuum. The IIE-process methodology is realized both within these sequences as across them. Hence the TSR of recursive *interrelationships* comprise circular causation and continuity in the framework of unified reality within and between knowledge-flows and their induced forms.

Many generalizations of the TSR (2), including the treatment of the mathematical complementation of knowledge-flows as 'de-knowledge', have been studied (Choudhury 1995a). These issues are too detailed to introduce here. The point to note is that there is a pervasive and inherent endogeneity manifest in the underlying general system of interrelations either in the knowledge or the 'de-knowledge' planes.

The scholastic school of Islam approached the study of Tawhid and world-system issues in a substantive way. See Faruqi (1977). Substantive theories of the learning economic and development domains have been propounded in the economic literature. See Hayek (1945) for his Austrian explanation of knowledge in economy theory. Recently Kirzner (1997) re-visited the Austrian theory of creative destruction using the entrepreneurial model of creative evolution.

The term 'de-knowledge' signifies ignorance, falsehood, and contrary to the *Tawhidi* world-system. The domains of knowledge and 'de-knowledge' remain mutually disjoint. They are separately consistent within themselves in the sense of pervasive complementarities signifying systemic unification in the case of the knowledge-induced world-system. Contrarily, the 'de-knowledge' world-system is characterised by pervasive marginalism caused by intrinsic competition, conflict and independence between the elements.

The *Tawhidi* Methodology of IPE & WS Applied to Social Accounting

Let us now examine how the interactive, integrative and dynamic methodology of creative evolution (IIE-process) can be applied to study the circular causation interrelationships between the three disciplines, namely Economics, Social Accounting and Management. This is the implication of the *Tawhidi* methodology of any *Shuratic* process model applied to diverse socio-scientific issues across complementing systems.

The study of sustainability of human wellbeing as the focus of socio-economic development requires economic organization of life and thought, an ethical accounting of the flows of income and cost in the light of ethical considerations of production, consumption and use. Next there is to be a discursive human environment that must enable decision-making on economic and social choices (Harahap, 2004). Social accounting entails measurement of the costs and benefits as premised on the ethical perspectives of social and economic development issues. In recent times, such accounting practices have come to be known as ecologically conscious social accounting with transparency and disclosure. In the management field, the ethical premises translate into ethical policy, programs and discourse premises of organizations and institutions. Such entities could be households, firms, corporations, community, nations, development organizations and the global community. The choices by discourse so made are causally determined by social and economic considerations, while the consequences are measured by ethical accounting practices.

Economics and Accounting thereby supply the specific ethical issues, while Management establishes the discourse mechanism to simulate the underlying ethical values and knowledge-flows that enable interconnection between the three domains with respect to the issues under examination. The emergent pragmatic cases are today found in ecologically conscious sustainable development, human development, social wellbeing and multidisciplinary studies.

Measurements in the Interacting Domains of Social Accounting, Economics and Management

Attention to the interconnecting ethical and moral issues between Economics, Social Accounting and Management in the financial measurements involving balance sheets and income statements can now be taken up. There are two perspectives in attaching ethical and moral values to such measurement indicators, such as fixed and variable assets and liabilities, composition of short, medium and long-run portfolio, costs, revenues and profitability and the resulting investment decisions based on such measurements.

The first perspective concerns the direction of financial resources into ethical directions that meet both the *Shari'ah* modes of financing as well as the suitability of the identified projects. The expectation then remains that such investments will generate good returns. But if they do not, the social investments will diminish in popularity as unprofitable projects that cannot stand the investors expectation for both social consciousness and stable and sheer profitable ones will replace sustained economic returns. Such has been the recent experience with Islamic banks that today increasingly globalize rather than socialize their operations while using a cursory understanding of the *Shari'ah*.

The second perspective on ethical and moral measurement and knowledge-induced ethical investment relates to a three-pronged approach that subsequently evolves into multi-dimensional system of network and linkages. The first part of the three-pronged approach is centered on human consciousness development, a project that is interactively taken up between the Islamic firms (principally Islamic banks) and the community (in its progressively expanded sense locally, nationally, across the *Ummah* and internationally). The second of the three prongs next links up with the first one by expansion of the Islamic economic activities into community, national and the *Ummah* socio-economic development. This is tantamount to the expansion of the *Shari'ah* rules developed and reinforced by learning in the first stage into the sustainability of socio-economic development.

The third part of the circular interrelationship involves the establishing of inter-linkages expressed by complementarities between the variables of the first two parts. These are now evaluated by the rules of *Tawhidi* relational epistemology between such variables and entities. The criterion function for the evaluation of this systemic unity is the social wellbeing function.

The central message in this part is that without the core principle of pervasive complementarities sustainability of the financing, growth and development parts of the Islamic political economy and world-system as complementary goals cannot be realized. Simulation of the social wellbeing criterion, subject to the circular causal interrelationships between the complementing variables of the wellbeing criterion is the functional method of evaluating unity of knowledge. Yet this is not automatically realized. The realization of such systemic unity of knowledge is primarily the function of human consciousness established by knowledge induction according to the epistemological foundations of the *Qur'an*, the *Sunnah* and learned discourse. The discursive method combing these three sources establishes the dynamics of the *Shuratic* process in respect to the IIE methodology.

Finally, to see the resulting multi-dimensional co-evolution of the three parts mentioned above, we need to invoke the circular causation interrelationship between the *Tawhidi* derived knowledge-flows and the financing and accounting variables and instruments and their measurements as recursively generated and governed by the evolution of knowledge-flows along the IIE-process. We thereby note that economics, social accounting and management involve setting first the discursively determined social wellbeing objective criterion with the necessary variables and development financing instruments in this criterion function. The circular causation interrelations are re-generated in the light of the constrained wellbeing simulation problem. The endogenous nature of the embedded system of relations and their complementing variables is signified by the simulation problem. The knowledge induction caused by the *Tawhidi* epistemology is exemplified by the invoking of the principle of pervasive complementarities. The choice of financing instruments, policies and human resource development are carried out through the *Shuratic* process that generates and sustains systemic complementarities by continuous production of knowledge-flows.

In the end we note that the social wellbeing function is simulated by considerations of a knowledge-induced epistemological outlook of Islamic political economy and world-system. An institutional perspective of the *Shuratic* process establishes the role of management. The selection of the variables of the social wellbeing function comes from the background of social accounting. The knowledge-flows that tie up the whole system by complementarities is derived and sustained through the medium of the *Shura-Tasbih* relationship, as mentioned earlier.

Selecting Variables for the Social Accounting, Economics and Management Interrelationships in the *Tawhidi* Framework of Unity of Knowledge

Here is an example of the simulation problem for social accounting in relation to the interrelationship between Economics, Management and Social Accounting:

Because of inter-variable complementarities the value of assets (A) equal the value of liabilities (L) as the total value (VS) of all portfolio of shares (S). The valuation of such shares (VS) is done according to a forward intergenerational overlapping model of asset valuation (Choudhury, 2004) in terms of the net yield rate (r). In the imperfect Islamic transformation the alternative rate as a ration between r and interest rate I can be tried out (r/i), with r increasing and i simultaneously declining as S increases across diversified and complementary portfolio of A and thereby L. The VS in the sense of this forward intergenerational overlapping model measures investment value (VI) at any point in time. In the sense of this intertemporal valuation, $A = L = VS = VI$.

The appropriate choice of A (hence S and I) is determined by risk diversification, which is causally complemented with production diversification. Both of these signify that (r/i) will increase with progressively declining i-value and increasing r-values. This kind of financial and development transformation is realized by the enactment of the participatory development financing instruments, such as *Mudarabah*, *Musharakah* and *Murabaha* (M) along with secondary financing instruments revolving around these principal ones.

The central ethical and moral parameter of social consciousness is brought about by the discursive variable denoted by θ -values. These assume ordinal values in respect to the institutionally perceived level of social transformation as indicated by the degree of complementarities between the variables realized in the social wellbeing function. θ -values induce all the variables in the circular causation process of generating and sustaining unity of knowledge signified by levels of attained and desired complementarities between the variables.

The overall governance of all variables by ordinal θ -values introduces the method of estimation of qualitative factors by means of quantitative simulation in recursive loops of changing θ -values as determined in the Shuratic process institutionally while evaluating the level of complementarities perceived to have been attained between the variables.

The Simulation Problem Interrelating Social Accounting, Economics and Management Issues in the Light of the IPE & WS methodology

Because r/i, and thereby M are endogenously related recursive functions of each other and the θ -values, and likewise, the number of shares (product diversification) S and the value of shares VS (risk diversification by portfolio diversification) are functions of (r/i), therefore, through the common effect of θ -values, there is a circular causation interrelationship between all the variables in the vectors each excluding the dependent variable in any given state of the relationship. Each of the variables is induced by the ethical and moral knowledge θ -values premised on seeking unity of knowledge.

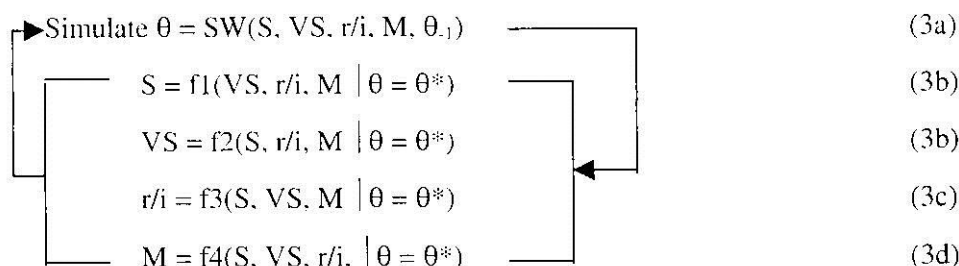
Let $\mathbf{x}(\theta) = (S, VS, r/i, M)[\theta]$.

Now the social wellbeing function is given by the ordinal θ -values, since this measures the degree to which systemic unification is attained by the combination of the accounting variables and the policy variable (M). Thus $\theta = SW(\theta, \mathbf{x}(\theta))$.

The circular causation structural relations between the variables are given by appropriate selection of such f-relations in respect to simulating the social wellbeing criterion. One such general

expression is given below. But we will use a simplified version of this model system. The important point to note in these systems models is that the epistemology of unity of knowledge is expressed through the principle of pervasive complementarities between the variables shown and such a relational epistemology of unity of knowledge works according to circular causation along the ever-evolving IIE-process. Also it is important to note that the overall objective of the unified system is to attain improving levels of unification in the system. Thus simulated levels of θ -values intra- and inter- IIE-processes in continuum can represent the attained levels of social wellbeing as ordinal indexes. These indexes are qualitative measures assigned institutionally (in the *Shuratic* process) but are used to estimate the total systemic interrelations by quantitative models.

The formalized simulation model takes the following form:



$\theta \in \Omega$ in terms of derivation of precepts and instruments needed to bring about systemic unity, i.e. premised on and leading to enhanced consequences of the principle of pervasive complementarities in world-systems. θ^* is a consensual value of θ in any given moment of the *Shuratic* or IIE process.

A simplified version of the simulation system (3a-3d) results from dropping the θ_1 term and thus by interpreting the simulation model as if it is evaluated structurally at every moment of the IIE-process. The structural regression equations system can be estimated recursively either over time or over contingencies, as the case may be (Hossain, Al-Hashmi & Choudhury Jr. forthcoming 2005). The model selection in most cases is of the Cobb-Douglas functional form with variable and increasing returns to scale. In this case the coefficients have the neat interpretation to be wellbeing elasticity parameters summing up to greater than unity. For indication of complementarities between the variables it is necessary that such elasticity coefficients be positive in value.

Policy Simulation Perspectives

If the elasticity coefficients are negative in value, as can be expected during the period of imperfect Islamization, then they ought to be transformed into positive values to meaningfully implicate complementarities in the social wellbeing function (index). This is a deeply policy sensitive empirical study. Fixation of appropriate positive values from less positive or negative ones is carried out by the institutional relevance of the simulation model. The transformation conveys important revisions in policy and instruments, which must be enhanced by heightened induction of the epistemology of unity of knowledge in the learning system. The treatment of the qualitative responses in quantitative simulation models with dynamic elasticity coefficients has been done by Choudhury & Hossain (2004). Explanation of this analytical method is too elaborate to be included in this paper because of its deeply mathematical and computer perspectives using the GIS Software of spatial analysis named ARCVIEW.

In the domain of interaction for unity between the perspectives of social accounting, management and economics, an example of the enacting the complementing changes would be to plan for a

greater role of human resource development along the *Tawhidi* lines to apply to the money-finance-institutional-real economy linkages. In such a case the money-real economy linkages will enhance the use of financing instruments (M). This would bring about the money-real economy linkage. In turn the complementing relations will be followed simultaneously by increasing values of (r/i), with increasing r and decreasing i. The other social accounting measures, such as S and VS now follow suite along complementary circular causation relations. The participation in the *Shuratic* process establishes the much needed transparency and ethical disclosure. It reduces asymmetric information and moral hazards and brings in place firm-clientele participation. All these are needed for an effective Islamic functioning of Islamic financial institutions (Harahap, 2005 forthcoming).

An Example of Balance Sheet of Islamic Financial Firm

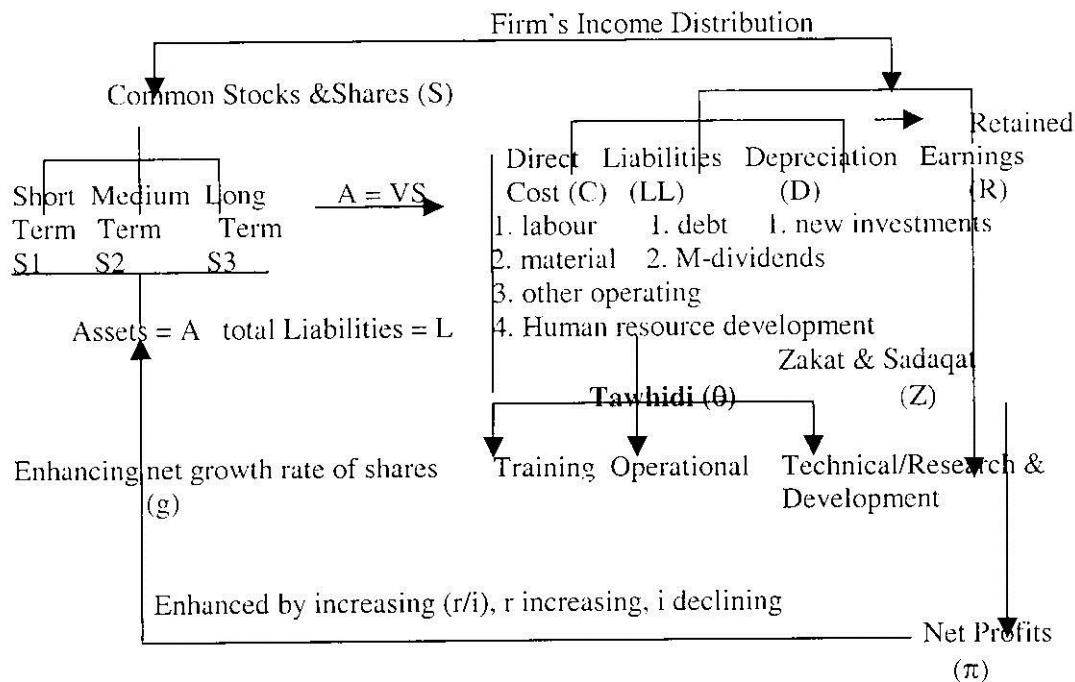


Figure 1: An Example of Circular Interrelations in an Islamic Financial Firm

$$\pi = [(1-2.5\%) (VS - (C + LL + D))(1+g)^t] [\theta] > 0, \quad (4)$$

Expression (4) is valid if and only if Value of Assets > Value of Liabilities over time with the joint impact of θ -values and market responses. This is of the nature of polity-market interaction in the Islamic political economy and is inherent in the theory of *Tasbih-Shura* circular interrelationships formalized earlier in this paper.

Clearly, the higher is the impact of spending on human resource development, labour, materials, other operating expenses, and depreciation recovery by new investments, the higher will be S and VS, but the lower will be the retained earnings. Consequently, the function of the Islamic financial firm is to increase resource mobilization of all types, not to increase savings. Indeed, each of the variables shown here is positively related with (r/i), with r increasing and i declining over the enhancing circular relationships shown by the recursive arrows.

Over time it is more likely in an investment prone economy with resource mobilization, for $VS > (C + LL + D)$, i.e. $A > L$. Hence both Zakat and Sadaqat and investments increase simultaneously. The proportion $[Z/(A-L)]$ is an empirical fact depending upon population size, portfolio and risk exposure to resource mobilization and intensity of the θ -impact. Since the circular causation interrelations shown in Figure 1 is centrally influenced by (r/i) , which in turn is a strong manifestation of money-real economy linkages caused by the combination of polity-market interaction influencing increasing returns (r) and decreasing interest rates (i), therefore, the whole circular causation is sustained by enhancing θ -values.

Conclusion

The simulation model system of structural regression equations with the social wellbeing function as the Islamic criterion for estimating the degree of unity i.e. complementarities in the system of circular causation interrelations can be empirically estimated. For launching such an empirical project of the IIE-process model within the *Tawhidi* perspective (systemic unity of knowledge) a databank along the lines of the suggested kinds of data and supported by the knowledge-centred Islamization within institutions and beyond it in the development sense ought to be established. Given such a data source with both quantitative and qualitative information, the various interactive, integrative and dynamic elements of social accounting, management and economics can be jointly studied for the benefit of enhancing social and *Ummatic* wellbeing and extending beyond to global wellbeing.

The *Tawhidi* worldview of the IIE or the *Shuratic* process along with its important *Tasbih* embedding goes beyond a simply cursory study by the essentially socially embedded complexities of dynamic learning systems. Islamic banks, financial and non-banking firms together with the Islamic Development Bank and the truly Islamic intellectuals ought to launch the proposed project of the *Tawhidi* simulation model within the scope of databank development, institutional restructuring and sustainable socio-economic development. These were pointed out in this paper.

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INSURANCE : AN ISLAMIC PARADIGM

*Dr. Abu Bakr Rafique***

Preamble

Insurance is considered an important economic organization in the modern world. Its importance is even more than that of the Banks in some considerations. Because the insurance can come forward and catch the hands of a person in distress, who has been affected due to destruction of a business, or damage of a transport or burning of an industry or sinking of a ship or any kind of unpredicted loss, which can not be performed by a bank. But the question arises here, whether is the insurance acceptable in an Islamic economic system or not?

The Islamic scholars have expressed diverse views in this issue. Some have accepted it with some modifications, some others have accepted it for general policies and rejected for life policies and some others have rejected the practice of insurance in totality.

The Objective

The objective of this study is to analyze the divergent views of *'Ulama* in this regard, to see how far these are compatible with the Islamic principles and to see whether is it possible to find out any Islamic paradigm of insurance or not?

Risks in human life and role of insurance to address these risks

Risk and uncertainty is an integral part of human life. Because men are to face these risks essentially due to some legitimate causes. These risks are different in respect of nature and gravity. These risks may range from minor financial loss to the millions of Dollars and even it may cause the loss of a life or lives, which could not be predicted earlier.

The people in different societies throughout the history are seen to have taken some measures to face these risks, specially the societies where the frequency of these risks were more, e.g. the people of Arabia in pre-Islamic society had introduced a special fund called al *'Aqilah*.

The objective of this fund was to provide financial assistance to the family of one who is killed unintentionally. This compensation is to be paid by the tribe of the person in whose hand the other was killed, even this fund would be used to compensate those who suffered from business loss due to some natural hazards.

Classification of risks

Now even after the advancement of society the people could not get rid of the risks in their day to day life. The renowned economist Dr. Nejatullah Siddiqi has classified the risks into three kinds, which are as follows :¹

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¹ In its practice every member of the society used to contribute some amount in advance to meet the aim of the doctrine of al-*'Aqila* which ultimately developed a culture of mutual co-operation within the tribe. Later, during the period of the holy Prophet (saw) the Prophet (saw) himself approved such practice."

(a) Business risk

This is such a kind of risk which is not possible to be measured earlier by any method. However the hope of gain is also associated with this risk as much as the fear of loss. Although the amount of gain or the loss can not be calculated here in a definite way but the entrepreneur is confident of the fact that he shall not lose the whole of his capital or shall not get an enormous amount of profit beyond his expectation.

(b) Pure risk

This is another kind of risk which involves only fear of loss, without any chance of gain. However, the incidence of such risk can be measured if not completely, but it is possible to be calculated approximately. For example the vehicles which are engaged for transportation of the passengers on a highway and the ships setting out on voyages in the sea are always on risk of getting accident on the highway or facing wreckage in the sea. But none can predict with certainty which one of the vehicles will face accident and which one of the ships will get wreckage. However on the basis of a data of an empirical study on a large number of vehicles and ships for a period of one year or more, it is possible to get an idea about the probability of accident in average, which may be used as the basis for possible accident in each item over a period of a year and an approximate loss due to this accident. This method is known as the '*law of large number.*'

This kind of risk can easily be faced collectively. By taking a collective measure the individuals feel secure. This collective measure is called **insurance**.

(c) Risk of Gambling

There is a third kind of risk, which is not an essential part of everyday life. This kind of risk is rather the result of voluntary option of taking this risk. Such risk entails both loss or gain. This is called **Gambling**. Here the loss is limited and upto the amount that one has invested for taking this risk, but the gain is unlimited. Here the factor which motivates someone to take this risk is the hope of gain only.

Involvement of Insurance

If these three types of risks are analyzed, we shall see that the first kind of risk i.e. business risk is an inevitable and indispensable for any enterprise. A society cannot progress and the business can not prosper and flourish without taking this kind of risk. It is rather praiseworthy and it has very positive aspect for providing a conducive environment for creating certain virtues flourishing courage, patience, perseverance and self confidence in the society. The more people will involve in this kind of risk the more flourishing and advancement will be guaranteed for a society.

Insurance has no role in this type of risk, excepting the fact that an entrepreneur can make insurance against an unpredictable risk of catching fire or sudden damage in natural calamity or theft etc. in favour of business firm which are related with pure risk.

Insurance has also nothing to do with the third type of the risk or gambling, which has been mentioned above. Because though it is unpredicted, it is neither a business risk, nor a pure risk, nor an essential part of life.

Insurance is only involved in the 2nd type of risk, which is called **pure risk** and to protect against this kind of risk it can play a positive role in ensuring the advancement of progress and flourishing business.

What is insurance?

After coming across to the literature related to insurance and upon studying its aims and objectives we can draw the definition of insurance as follows :

"Insurance is a system of providing assurance of standing behind the distressed at the time of financial loss, injury or death due to occurrence of some unpredicted accident, in the light of an agreement against paying certain amount of premium, to compensate the loss as per clause of the agreement."

This can be clarified through some analytical explanation given by Dr. Nejatullah Siddiqi in the following extract:

"Suppose a particular shop in a market in occasion catches fire. Some of the causes of fire are known to us. There may be some other causes not yet fully within the scope of our knowledge... There are a large number such markets, in each one of which such accident do occur. This has been happening for a very long time. If the average of the incidences of fire is calculated from the record of fires in a large number of markets covering an extension period, it is possible to calculate the number of shops catching fire out of say, a hundred thousand in a year ... The inferences drawn from all these computations can be used to work out compensatory formulae for the financial implications of these accidents..."

Such calculations enable individuals in groups to cope with the burdensome financial implications of the type of measurable risk discussed above, by periodically paying small sums of money as premium."ⁱⁱ

He also adds that:

"It is indeed to be borne in mind that insurance is concerned with the financial implications of measurable pure risks".ⁱⁱⁱ

'Ulama's views regarding Insurance: an analysis

The 'Ulama or the Islamic scholars have expressed different views in this issue. These views can be summarized as follows: ^{iv}

(a) A group of 'Ulama hold the opinion that Insurance is permissible, provided that it must be free from the element of interest (*riba*).

Those who share this view are: *Shaikh Muhammad 'Abduhu*, The renowned Hanafi jurist *Shaikh Ibn 'Abidin*, *Shaikh Muhammad Taqi Amini*, *Shaikh Mustafa Zarqa*, *Shaikh Muhammad al-Bahi*, *Imam Ayatullah Khumani* and many others.

(b) Another group of 'Ulama and scholars hold the opinion that general insurance practices are permissible, not a life insurance policy. Their argument is that it involves the element of gambling (*Maysir*) and uncertainly (*gharar*) and it also contravenes the principles of *wasiyyah* and *wirathah* (will and inheritance)!

Some of those who hold this view are *Shaikh Abdur Rahman 'Isa*, *Shaikh Ahmad Ibrahim*, *Shaikh Shawkat Ali Khan*, *Mufti Muhammed Bakheet*, *Shaikh Muhammad Abu Zahra*, *Shaikh Jadul Hoque Ali Jadul Hoque* (the former Rector of Al-Azhar University). A statement with similar view was also published in the name of Muslim Brotherhood (*Al-Ikhwaniyyah Muslimun*) in 1941, and a similar decision was taken in the Muslim World League conference held in 1965 at Cairo.

(c) A third group of 'Ulama have rejected this practice of Insurance in totality regardless of the question whether it is a general or life policy. This view is held on the ground that it generally involves the elements of interest (*Riba*) gambling (*maysir*) and uncertainty & deceiving (*gharar*).

This view was held by *Shaikh Mustafa Zaid*, *Shaikh Abdullah al-Qalgeeli* and *Shaikh Jalal Mustafa al-Sayyid*.^v

An analysis of the above mentioned views :

Now we shall try to study the views of those who have rejected all kinds of insurance or some of them and analyze the arguments on the basis of which they have rejected it, to see how much it is correct and logical.

First of all we shall discuss the argument of those who have rejected all sorts of insurance. Their arguments for rejecting insurance in totality are as follows:

(a) That insurance involves the elements of interest (*riba*):

As the Islamic *Shari'ah* does not allow any involvement with interest, so Insurance is not allowed. We shall see here whether is the involvement of insurance with the elements of interest an integral part of Insurance, and whether is it possible to get rid of any involvement with the elements of *riba*.

It is true that the conventional system of insurance is involved with interest. But this involvement with interest is not an integral part of insurance. As a matter of fact the amount of money that is paid by the policy holders as premiums for the insured object accumulates into a huge fund in the hands of Insurance Companies. It has been observed that the companies while fixing up the rate of premium, they fix it up at a fit higher rate than the minimum required for the payment of claims from the policy holders and thus the total money paid in a particular year is obviously less than the amount collected in that corresponding period and as such the companies under the conventional system try to invest the surplus money in a manner that the chances of loss are minimized and a constant growth of the capital is ensured. This is why they invest this capital through purchasing interest bearing securities.^{vi}

The companies under conventional system of insurance do invest their fund in an interest based financial institution only to lessen the rate of premium, which would have been higher if the capital had remained inactive. Dr. Nejatullah Siddiqi suggests that "If this capital can be gainfully used through some interest free channels, the insurance system would obviously get rid of the element of interest".^{vii}

Dr. Nejatullah Siddiqi further proposes that the problem of using the fund collected from the premium of insurance in an interest free system can successfully be solved through introducing state controlled insurance companies. Because it is possible for the state to invest the money in some schemes whose productiveness is certain and where there is no question of loss or bankruptcy. As for private insurance companies it is also possible to operate in very limited sphere through exploring avenues of comparatively safe and profitable investment of the surplus capital even in an interest free economy. Fortunately this matter has become easier now after the success of Islamic Banking system in different countries.

Someone may raise a question that the insurance contract inherently implies as the insured is promised an amount far in excess of what he will have deposited in installments before the occurrence of any accident. This question has also been answered by Najatullah Siddiqi saying that.

"This is a baseless assumption as the *Shari'ah* does not regard absolutely every increment as interest. Money paid as premium is not in the nature of a loan, and the payment of a claim does not amount to returning the loan with an incremental amount that may be considered interest. In the true spirit of it, a premium payment is a kind of co-operative contribution towards the availability of a useful social service".^{viii}

(b) That insurance policy is not free from gambling, which is prohibited in Islam in the light of the *Qur'an* and *Sunnah*. It has been urged that as a gambler pays certain amount of money in

consideration of which he hopes for material gain, likewise a person pays premium with the hope for a chance of material gain with a large amount of money. It resembles gambling.

In response to this argument we would like to quote here an observation of *Shaikh Mustafa al-Zarqa* who maintains that:

“the gambler in a transaction of gambling or betting is always hoping for material gain in a chance with the attitude of defeating each other instead of a co-operation. In contrast the parties in a contract of insurance are bound together in view of mutual co-operation and goodwill for providing material security for the orphans, windows and other dependents as well as one’s own self against an unexpected future loss, damage or peril.”¹⁸

Dr. N.U. Siddiqi also confirms that,

“The games of chance prohibited by the *Shari’ah* have no place whatever within the scheme of insurance.”¹⁹

(c) That the life insurance policy necessarily means a challenge against the will of Allah and a disbelief in predetermination of fate and it leads to ensure one’s life against death, and as such, it is unlawful and against the spirit of *Shari’ah*.

In response to this argument we can say that one does never aim to revert death through a life policy, nor he believes that insurance can control one’s life and death challenging the will of Allah (swt). But an insurance policy simply means that

“both the insurer and the insured in a contract of insurance mutually agree to work for a compensation or security against an unexpected tragedy. Such concept is of course in line with Islamic principles, whereby Islam encourages the *Ummah* to strive hard to overcome difficulties in their lives”.²⁰

(d) Now we shall see whether does insurance contain the elements of exploitation, uncertainty, fraud or detrement etc. which are forbidden by *shari’ah* in all kinds of transactions?

In response to this question we can say that, the possibility of exploitation, fraud or detrement against insurance can easily be removed from Islamic insurance. There is a possibility of fraud and exploitation in conventional insurance only, that some times the insurance companies realize unreasonably high rate of premium, which is considered as cheating. On the other hand the insured tends to make false declaration regarding his age, health condition and financial status, this is also considered as fraud, but an Islamic Insurance must be free from all these hazards.

Insurance is also free of the allegation of detrement, as no third party is harmed by an insurance contract.

(e) So far as the question of uncertainty (*gharar*) is concerned, it has been clearly observed by the researchers that

“a contract of insurance also does not involve the element of *gharar* (uncertainty). In an insurance policy, generally the subject matter is the property against which risk is presumed to occur in the future. The subject matter of insurance contract is definite and certain. Similarly the subject matter of a life insurance policy is the life of the assured, which is also definite in the sense that the assured had been given a life by Allah (swt) and will one day die by the will of Allah (swt)... Therefore, the allegation that insurance involves the element of uncertainty (*‘garar’*), making it invalid, is groundless”.²¹

Dr. N.U. Siddiqi also observes that:

“In the case of an insuring agency the amount of money that it will receive from, and give to the group of insured persons is determined and known. This certainty is based on the law of average

which constitutes the basis for the calculation of premium rates and claims. Chances of errors in these calculations are very slim.^{xiii}

Insurance : in Islamic View Point

In the light of the above discussion we can come to a conclusion that insurance is one of the modern methods of risk management, and it is free or it can be made free from those evils for which a particular transaction shall be considered forbidden. As far as the objective of insurance is concerned it is rather desirable in the light of *Shari'ah*. Allah (swt) encourages the *Muslims* to cooperate each other in good and act of welfare. He says :

تعاونوا على البر والتقوى ولا تعاونوا على الإثم والعدوان (المائدة: 2)

“Maintain mutual cooperation among yourselves in righteousness and piety and do not cooperate in sin and transgression”.^{xiv}

Another argument in favour of insurance in the light of *Shari'ah* is that the financial burden on the members of a society involved in pure risk can be lightened with the help of insurance. This is especially emphasized as one of the very good deeds in the eye of Islam.

The prophet (saw) has said :

من نفس عن مؤمن كربة من كرب الدنيا نفس الله عنه كربة من كرب يوم القيامة ومن يسر على معسر يسر الله عليه في الدنيا والآخرة

“Whosoever removes a worldly grief from a believer, Allah (swt) will take away from him one of the griefs of the hereafter. Whosoever alleviate a hardship (from a needy person) Allah (swt) will alleviate a hardship from him in both this world and the hereafter.”^{xv}

According to Islam it is rather a prudence for a *Muslim* to make arrangement beforehand for a compensation against possible losses involved in his wealth or life, in cases of pure risk, whether individually or collectively. In fact insurance is nothing except a collective measure for compensation of loss.

Prophet (saw) is reported to have said in this connection :

“أن تركت أولادك أعياء خير لك من أن تتركهم عالة يتكفوف الناس”

“It is better for you to leave your children wealthy than to leave them poor asking others for help.”^{xvi}

The prophet (saw) is further reported to have said :

الساعي على الأرملة والمسكين كالمجاهد في سبيل الله أو كالذي يصوم النهار ويقوم الليل”

“The one who looks after and works for widow and for a poor person (like the orphans etc.) is like a warrior fighting for the cause of Allah (swt) or like a person who keeps on fasting the day and praying the whole night”.^{xvii}

Insurance : An Islamic Paradigm

We believe that from the discussion we made in the previous sections of this study, it has become clear to the readers that insurance is one of the basic human need, because an accident and its financial consequences requiring insurance coverage is universal and its importance for keeping a society continued towards its advancement is undeniable. One's scaping from a disaster caused from a sudden death, an accident, disability, catching fire, storm, drowning, theft or damage of transport due to road accident and all sorts of unpredicted losses are not dependent on one's voluntary actions or precautions. Sometimes the victim and his family may be destructed or may reduce to penury. This reality demands that a humanitarian system must prevail in the society by

which the victim can be provided a consolation, and his losses may be compensated. This can be done through insurance and, as such, insurance is treated as a basic human need in the society.

It is to be noted that the difference between an Islamic Insurance and the conventional system of insurance is not of principle and objective but of spirit and operation.

Both the conventional and an Islamic system of insurance follow the same principle of insurance, as both consider it an association of large number of people facing the same kind of risk on an agreement based on the principle of the law of large number, for compensating the loss of one who faces an accident. The objective of Insurance in both the conventional and Islamic system is to keep the wheel of economy running in the society.

However, both of these two insurance systems differ from each other in respect of spirit, because the spirit of insurance in an Islamic system is religious and rather humanitarian, whereas it is secular and social in the conventional system. Both of them do also differ in the way of implementation. The Islamic system must follow the principles of *Shari'ah* in investing the fund and laying the terms and conditions. So that it must not involve in any element of interest, must be free from any condition, which leads to exploitation, uncertainty, cheating or creating a situation of quarrel. Contrarily, all these are not necessary in the conventional system of insurance. Usually the fund is invested in the conventional system for purchasing securities drawing interest. Both the insurance company and the insured try to exploit each other taking the advantage of loopholes of the system, which is not unknown to the people.

Like the conventional system of insurance the Islamic insurance system permits both the general and life schemes of insurance. However according to the Islamic system of insurance it is called as *Takaful*. The very word *Takaful* has been derived from an Arabic word (كفل) *kifl*, meaning 'burden'. It has been used in the Qur'an to denote the above meaning as:

ومن يشفع شفاعة سيئة يكن له كفل منها. (النساء: 85)

"And whoever recommends and helps an evil cause, shares in its burden."^{viii}

'*Takaful*' is broadly similar to conventional mutual insurance in the sense that it involves a number of participants sharing risk on a cooperative basis.

The most significant difference between '*Takaful*' and a conventional insurance is that a '*Takaful*' operator (which is effectively the insurer) is prohibited under the *Shari'ah* law from investing in certain modes of investments.

'*Takaful*' means sharing the responsibility jointly. The word '*Takaful*' itself depicts the spirit of insurance in Islam. An insurance system, according to Islam, is nothing but an association of a group of people facing the risk on their property or life and desiring to agree upon a point that each of them shall contribute a certain amount of money for a certain period of time as donation to the association, and the association in return, shall guarantee to compensate for the loss that incurred upon a member of the association due to facing an unpredicted accident.

The following principles may be detailed for an Islamic insurance '*Takaful*' system :

- (a) That an insurance system in the eye of Islam is an important as social security. Because social security aims at relieving the destitutes who are deprived from fulfilling the basic needs.
- (b) An insurance system also provides public welfare through ensuring to people in distress caused by an unforeseen accident.

(c) that '*Takaful*' is a voluntary 'welfare association' membership of which is open to those who are afraid of facing a risk in their wealth or life, and desire to be compensated for any loss incurred due to death, disability, fire, flood and other accidents.

(d) That the policy holders in an Islamic insurance (*Takaful*) are the members of an association, and the part of premium paid to *tabarru'* fund is considered as donation dedicated to those who face a loss due to unpredicted accident.

(e) That the nominee in a '*Takaful*' insurance is considered a trustee. He is not entitled to own the money received from the company. This amount is an '*amanah*' to him and he is responsible for distributing this amount among the heirs of the deceased according to the Islamic law of inheritance.

(f) That all the terms and conditions of a '*Takaful*' insurance should be very clear and free from any kind of ambiguity and uncertainty (*gharar*) so that they do not lead to any situation of quarrel and a controversy.

(g) That none of the parties, i.e. insurer and the insured or (policy holder) can exploit the other through concealing the facts, exaggeration, or trying to seek excuse from paying the compensation on false plea etc.

(h) That all financial transactions like deposit, investment & payment of compensation, etc. must be free from any element of interest (*riba*) or gambling (*maysir*) etc. which has been prohibited by the injunctions of *Shari'ah*. On the other hand the amount paid by the policy holders apart from *tabarru'* where applicable should be invested on the principle of *Mudaraba* and on clear terms and conditions regarding the proportion of profit or dividend etc.

Further the money collected in *tabarru'* fund should also be invested in an Islamic mode of investment with an objective of creating better provision for compensating the distressed policy holders in need as an act of humanity.

In the light of the discussion and analysis of different views of '*Ulama*' it has become clear now that the most considered and latest view of the Islamic scholars ('*Ulama*') is that the Islamic Insurance (*Takaful*) policy is acceptable in the eye of Islamic *Shari'ah* whether it is general policy or a life scheme.

The general insurance policy usually includes the properties which are at risk, and the life scheme, on the other hand, shall include the risk related to life and health. Usually the tenure in a general policy is one year, renewable for the subsequent period of time, upon agreement of both the parties, while a life policy is usually taken for a long term basis.

General Insurance Policy

The properties insured in a general insurance policy are those which are at risk, and the policy holder desires to obtain a protection against this risk by ensuring a compensation of loss, if occurs, through paying some amount of money as *tabarru'* (donation) to an associated fund. In case of any accident the policy holder will be compensated for his loss upto the maximum of the policy amount.

The items include in a general policy are usually the properties like motor vehicle, house or shop, business organization, industry, marine vessel, airplane, business commodities being imported or exported and so on.

The premium is determined here on the basis of probability of occurrence of accident in each particular item and the amount of compensation that may have to be paid during a certain period of

time (say one year). This is fixed up on the principle of the law of average and based on empirical study and analysis of facts on a long period of time.

The premium paid in a general policy is considered a donation (*tabarru'*) to the organization. The policy holder should not have right to claim any amount if no occurrence of accident is proved during the period.

However, Mohd. Masum Billah opines that

“For a no claim status, the insured may only have the right to claim a no-claim bonus (NCB) from the Insurance Company on a *Mudaraba* practice basis.”²⁰

I would like to differ with Masum Billah in this opinion in two aspects:

(a) That his idea of giving the right for claiming a no-claim bonus (NCB) to the policyholder contradicts the idea of *tabarru'*. Because after we have agreed upon that the Insurance system in Islam is like an association of mutual co-operation and joint responsibility (*Takaful*). So the premium here is nothing but a contribution to this fund dedicated to those of the members of this association who face financial loss due to some unpredicted accident. So in case of occurrence of no accident with any of them he should not have any right to claim any of the amount paid by him as donation (*tabarru'*).

(b) that opening a provision to the policy holder for a right to claim any amount as (NCB) shall lead to uncertainty (*gharar*) and controversy in future. Both of these are prohibited according to the *Islamic Shari'ah*. And, as such, any transaction where these two elements are found can not be accepted in Islam. Islam rather wishes to eliminate these evils from human life, especially the business activities. Transactions based on uncertainties are considered *gharar*. The policy holder does not know how much he would receive if there is no claim for compensation due to not facing any accident. Dr. Nejatullah Siddiqi has clearly mentioned that: “all sales or exchanges of service where the rights and obligations of each party are not known and certain are based on *gharar*”.²¹ Here the policy holder does not actually know anything, how much he is going to receive as NCB in case of not facing any accident.

(c) The objective of insurance is to lighten the financial burden from the members of a society involved in pure risk and not to provide financial benefit out of the amount donated to help the distressed at the time of financial loss caused by accident.

Further, I do not agree also with Mohd. Masum Billah on his suggestion that : “The paid in any kind of general policy may be regarded as *al-Musahama* (contribution) in which the greater percentage should be given to the charitable fund. The remaining percentage may be treated as capital of the insured under the *Mudaraba* financing technique.”²²

This is also for the reasons stated above.

Life Insurance Policy

The central idea of Life Insurance Policy, according to my opinion, is the same as that of a general insurance policy, i.e. both are based on the idea of '*takaful*' or joint responsibility i.e. joining hands with others as a member of a welfare association founded in the spirit of extending assistance to the members of this association, who are in distress. Here a policyholder, as the case with a general insurance policy, shall contribute an amount of money as donation (*tabarru'*) to the association with a noble objective of helping the widows and orphans of those members who die in accident or

for helping those members who get injuries due to some unexpected accidents and reduce to disability.

The difference between the general policy and the life policy, according to my analysis, is as follows:

- (a) that the object of insurance (the insured) in general policy is property, where as it is here the life and health of the policy holder.
- (b) That the period of insurance in general policy is normally one year but it is longer in the case of a life insurance.

The policyholder (the insured) shall not have the right to get refund of any amount paid for insurance as *tabarru'*, because it is considered as non-refundable donation for those who face accident and loss of life or organs. If no accident occurs to the policyholder he will not have any right to claim any amount of that. Here the rate of premium shall be determined based on the *law of large number*. The policy holder shall have full right to claim the amount invested in *Mudaraba* alongwith the profit and or dividend as per provision of the policy, after the policy is or even if the policy holder decides to make the policy paid up before the maturity of it.

The differences between the conventional system of life insurance and the Islamic system are as follows:

- (a) That the conventional system of insurance does not have any fund as *tabarru'* (donation).
- (b) That the rate of return is fixed up in advance in the conventional system of insurance, which is nothing but interest (*riba*).
- (c) That the Islamic insurance policy prohibits investment of the fund collected as premium in any business based on *riba*, whereas the most of the conventional insurance companies invest their capital with interest based organizations.
- (d) That the nominee in the conventional system of insurance is entitled to receive full amount of policy money without any question whether the amount shall be distributed among the heirs of the deceased or not. But here in an Islamic Insurance the nominee is nothing more than a trustee and, as such, he has to submit an affidavit that he will distribute the money among the heirs as per principles of Islamic law of inheritance.

The premium paid in the life insurance policy shall be devided into the following heads:

- (a) The premium of donation to the charity fund (*tabarru'*), determined based on the *law of average*. Say for example .5% of the total policy amount to be paid per annum. And thus if the amount of the policy is, say one lac, the policy holder shall have to pay an amount of Tk. 500/- per annum to this fund. It will be called as *tabarru'* (or donation to the risk fund).
- (b) The premium for investment in the *Mudaraba* Account. This amount shall be equal to that of the actual amount of the policy divided into the total period of the policy. Say for example if the policy amount is Taka one lac and the period of policy is 20 years, then the premium for *Mudaraba* Account shall be Taka five thousand (Tk. 5000/- per annum an so on.

The company shall be in obligation for compensating the loss to the policy holder (insured) in case of occurrence of an accident, up to the limit of the policy amount in the maximum. The rate of compensation shall be determined clearly in the agreement, say for example full of the policy amount for accidental death, or reducing to total disability, half of the policy amount for losing major organs like hands, legs or eyes etc.

However the policy holder will not be entitled to claim any amount that contributed to the *tabarru'* fund in case he does not face any accident within the period of the policy. On the other hand the

company shall have the obligation to pay back the amount paid as premium for investment in the *Mudaraba* Account of the company apart from the *tabarru'* fund alongwith the profit and/or dividend at the ration agreed upon with the organization.

This proposal may be elaborated with an example as follows :

Suppose Mr. 'X' is a client. He proposes to open a life policy with an Insurance company named "*Millennium Takaful Insurance Co.*" The amount of the policy is say Taka one lac, and the duration is 20 years.

According to the terms and conditions laid down by the company Mr. 'X' has to pay part of the premium as donation @ 0.5% of the policy amount to the *tabarru'* fund of the company i.e. Tk. 500/- per annum. The policyholder shall have also to pay another amount as premium, which is equal to the total amount of the policy, divided by the total period. And, as such, he has to pay Tk. 5000/- per annum as premium. This amount is specified for investment under *Mudaraba* system on an agreement that the profit will be distributed at the rate of 2:1 (i.e 66.6% for the policy holder and 33.4 for the company). No separate commission shall be imposed upon the policyholder for the agents.

If Mr. 'X' dies in an accident within the duration of the policy then his nominee or his heirs as per wasiyyah, shall be entitled to claim Taka one lac as full entitlement which will be paid from *tabarru'* fund as assistance to the distressed.

In addition for this his nominee/heirs will also be entitled to get back the full amount paid as premium to the *Mudaraba* account alongwith the share of profit (@2:1 of net profit earned per year on that amount).

But if Mr. 'X' survives until the maturity of the policy then he will not be entitled to claim any amount paid to *tabarru'* fund i.e. Tk. 500/- x 20 or Tk. 10000/-.

However he will be entitled to claim the full amount of premium paid for investment in the *Mudaraba* fund i.e. Tk. 5000/- x 20 = 100000/- plus the share of the profit drawn over his investment as per agreement say another amount of Tk. 100000/- or a total amount of Tk. 200000/-

Mr. Masum Billah's suggestion : a criticism

Mr. Masum Billah suggest that :

"If the assured is still alive upon the maturity of the policy period, he has the right to claim from the insurer the paid premiums, the share of the profits according to the company's policy and dividend if any. But if the assured dies at any time before the maturity of the policy, the claim of the nominee(s) may include paid-premiums, share of profits made over the paid-premiums, bonus and dividends according to the company's policy plus a donation from the company's charitable fund according to the financial condition of the beneficiary(s) of the assured."²³

In the above statement Mr. Masm has done the following mistakes:

Firstly

Here in this proposal Mr. Masum Billa has not mentioned what will be the amount of donation? Is it that of the policy amount or it shall be left to the discretion of the company?

This proposal will lead to uncertainty (*gharar*), and thus it will create a state of quarrel and controversy between the company and the nominees (heirs) of the deceased who dies before the maturity of the policy, for the following reasons :

i. As he suggests that in case the policy holder (the assured) dies before the maturity of the policy, his nominees (heirs) may have the right to claim (a) paid premiums (b) share of profits made over the paid premiums (c) bonus and (d) dividends according to the company's policy, plus (e) a donation from the company's charitable fund according to the financial condition of the beneficiary(s) of the assured.

Here in the above proposal so far (a) and (b) is concerned they are clear and understood, but as for (c) and (d) these are not clearly understood. Because once the policy holder agrees that the money paid in premiums shall be invested on *Mudaraba* mode and that he will be entitled for certain percentage of profit made over the premium then there remains no further provision for being entitle to claim any bonus or dividend. This entitlement is uncertain and will be considered as *gharar*.

ii. As he further suggests that the nominee(s) of the deceased shall be entitled to claim a donation from the company's charitable fund according to the financial condition of the beneficiary(s) of the deceased.

This proposal shall also lead to the state of serious difference and controversy between the nominee(s) and the company in determining the financial condition of the beneficiaries, which needs not to be explained, whereas the financial condition of the assured has already been determined by him through fixation of the amount of the policy and the premium per annum, and as such, the nominee(s) of the deceased should have the right to claim the full amount of the policy if he dies in accident, and the part thereof as per agreement in case of loosing organs or in case of natural death.

Secondly

Mohd. Masum Billah has failed to differentiate here between the nature and objective of the amount of premium paid to the donation fund (*tabarru'*) and the amount of premium paid to the *Mudaraba* fund. The fact is that the *tabarru'* fund is always considered as donation. However the amount of *tabarru'* fund is determined based on the amount of the policy. Our proposal is .5% of the policy per annum at the maximum. The assured or his nominee shall only be entitled to claim any compensation if the assured expires before the maturity of the policy due to one or more than one of the insured perils then company shall pay the total amount to the nominee of the deceased as donation, for distributing that amount between his heir(s) according to the Islamic law of inheritance. If the assured survives but loses some parts of his body then he will be entitled to claim from the *tabarru'* fund an amount of donation as agreed upon in the contract as per term and condition of the policy. Determining the amount of donation should, in no case, be left to the descretion of the company.

On the other hand the amount paid as premium to be invested in *Mudaraba* mode always belongs to the policy holder. He will always be entitled to get refund of the money paid to this account + the share of the profit according to the agreement. If the policy holder dies before the maturity of the policy he will get back the actual amount of premium paid alongwith the share of profit and if he survives upto the maturity of the policy then he will be entitled to get back the whole amount paid by him plus the amount of share of the profit drawn over his premium during the whole period as per agreement.

However I do agree with the proposal of Mohd. Masum Billah that : The agent in a life insurance policy is not supposed to be paid his salary out of the premiums of the insured, because they work for the company and thus should be paid by the company.”

It should be noted that the whole amount of the money received by the company as premium is to be invested on *Mudaraba* policy. So the profit shall be calculated after deducting the amount spent as commission or salary to the agents and all other administrative costs incurred in running the business of the company. So no amount should be imposed on the policy holders as commission to the agents.

Further, it has been proposed by some of the writers on mode of operation of Islamic Insurance that, In the event of surrender of the policy, the incumbent participant will receive the proportion of his/her *Takaful* installment which has been credited to participant's (insured's) account at the end of the policy period i.e. upon maturity.²⁴

I would like to differ with this proposal of getting back of the amount paid as premium alongwith the proportion of profit as per agreement, after the maturity of the policy. I rather suggest that if any of policy holder is not willing or unable to continue his policy then his premium and the share of profit over the premium invested in *Mudaraba* business should be refunded at the end of that corresponding year after closing the company's account why should he wait until the maturity of the policy if he is no more a participant of this policy?

The conclusion

In conclusion we can say that the insurance policy, whether is it a general policy or a life policy under an Islamic paradigm is a blessing for the society. It is based on the principle of co-operation and sense of mutual responsibility [*Takaful*] to those who are in distress. It is free from all sorts of evils which are prevailing in the conventional insurance system, like interest (*riba*) gambling (*maysir*) uncertainty (*gharar*) and fraud (*khida'*) etc.

References

1. See, The author's, *Insurance in an Islamic Economy* (The Islamic Foundation; U.K.) reprint 1997, PP.13-21.
2. See Op.Cit, PP. 18-20.
3. Op.Cit. P. 20
4. For details please refer to Masum Billah's '*Islamic Insurance [Takaful]*' Op.Cit. Chapter two.
5. See also, M.N. Siddiquis '*Muslim Economic Thinking, A survey of Contemporary Literature*. Studies in Islamic Economics (ed) Khurshid Ahmad. The Islamic Foundation, U.K. 1980, PP. 265-315.
6. See for details. Nejatullah Siddiqi's, Op.Cit. PP. 35-36
7. Op.Cit. P. 36
8. N.U. Siddiqi, Op.Cit, P. 38
9. See, Mohd. Mosum Billah, Op.Cit, P. 32 quoted from Al-Zarqa Mustafa, Nazom al-Ta'meen, Muwassasatul Risalah, Beirut. 1984, P. 46.
10. See, N.U.Siddiqi, Op.Cit, P. 35.
11. Mohd. Masum Billah, Op.Cit. P. 31
12. See, Mohd. Masum Billah, Op.Cit, PP. 32-33
13. See *Insurance in an Islamic Economy*, P. 41
14. Al-Qur'an; 5:2
15. Sahih *Muslim*. This hadith is narrated by Abu Hurairah (R). See also al-Nawawis forty Hadith (Hadith No. 36)

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16. Sahih Bukhari, Vol. 8, Narrated by Sa'ad ibn Abi Waqqas (R)
 17. Sahih Bukhari, Narrated by Safwan ibn Salim (R)
 18. Al-Qur'an; 4:85. (Tr. A. Yousuf Ali)
 19. See; the author's "*Islamic Insurance (Takaful)*" P- 44
 20. See; Nejalullah Siddiqi Op. Cit. P- 41
 21. See; the author's "*Islamic Insurance (Takaful)*" P- 44
 22. See; his books "*Islamic Insurance (Takaful)*" P- 46
 23. See; the author's "*Islamic Insurance (Takaful)*" P- 46

ISLAMIC ENDOGENOUS LOANS

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Abstract

Islamic opposition to riba opens the way to an immensely creative possibility – a new way to further productive capacity, material efficiency and economic justice. The new way, moreover, enables societies to control their own destiny and free themselves from elitist and foreign financial colonialism. Above all, it enables Islamic societies to work together in a common cause and to give a moral, intellectual and material lead to the rest of the world.

*At the centre of the new way are Islamic endogenous loans. Conventional endogenous money issues from the banking system, bears interest, and is **not** usually directed at productive capacity. In complete contrast, Islamic loans are issued interest-free by the state and are generally administered by the banking system on market and private property principles. The loans are **always** directed at productive capacity and, because they bear no interest, create productive capacity at one half, or less, of the present cost for:–*

- **Public capital investment** -- hospitals, schools, bridges, waterworks etc.
- **Private capital investment** as long as such investment creates new owners of capital and is part of policy to enable all individuals, over time, on market principles, to become owners of substantial amounts of productive capital.
- **Green capital investment**, particularly for clean, renewable energy.
- **Small and start-up businesses** thereby freeing them from the crushing pressure of interest-bearing debt. (No requirement for wide ownership.)

Since the loans address all the main aspects of the real economy, the banking system can become genuinely Islamic and have no need to be involved with either the creation of money or the imposition of riba.

1. *Riba*/interest is not necessary

Riba is wrong. Which is why Islam opposes it.

Yet there is another, separate, argument against *riba*, namely, that **interest is not necessary**. The cost of administration can be an element of interest but such cost can often be low, even minimal. In the case of public capital investment, moreover, the administrative cost is often substantially borne *by the borrower* and *not* by the lender (e.g., as when a government collects fees and taxes with which to repay its debts). Furthermore, part of interest payments can be in effect a guard against loss. But if collateral is adequate or largely not involved (e.g. when a government

undertakes the obligation to repay, or when specific provision is made for collateral), interest is *not* necessary.

The effects of interest are complex but in Aachen, Germany, interest on capital is 12% of the cost of rubbish collection; 38% of the cost of drinking water; 47% of the cost of sewage; and up to 77% of the cost of public housing. Indeed, it has been estimated that an amazing 50% of the price of *all* goods and services relates to borrowing costs (principal and interest). Overall, the cost of interest causes 80% of the population to pay out much more than they receive; 10% are in balance; and the last 10% receive very much more than they pay out.¹ Internationally, of course, the effects of compound interest are such that whole societies are trapped into an ever-increasing debt which they can never repay, and the attempt to repay in practice results in their economic resources being ripped off to outsiders.

So the question arises – Why should there be interest at all? For a start, the original principal of the loan is *created out of nothing* by the pressing of computer buttons (as all bank loans are) and then interest is added. Why should something created out of nothing give any right – any right at all – to receive interest?

It is time that Muslims recognised that interest can be viewed as a tax, a very large one, which is not only wrong but also unnecessary. In making that recognition, Muslims will easily come to a further recognition – that, if interest is eliminated, *the cost of productive investment can be halved or more*.

2. The conventional definition of endogenous and exogenous money is a lie

Conventional economics and neoclassical finance capitalism, however, are intent on maintaining the existence of interest. For them, interest is at the heart of everything and this can be understood by considering the conventional definition of endogenous money as that which issues from the banking system.

But a visit to any dictionary reveals that 'endogenous' has the meaning of 'coming or growing from within' (and 'exogenous' has the meaning of 'coming from without'). Thus the conventional claim that money coming from the banking system is endogenous (and money coming from the state is exogenous) is a disgraceful twisting of words for it is essentially being claimed that government and other institutions at the heart of society are in reality outside and only the banking system is inside.

The conventional justification for this twisting of the meaning of words, however, is that it is referring to the economy (and not society) and that the banking system efficiently allocates resources to the productive economy while the government cannot be trusted to do so.

But supposing it is true that – as happens today – the banking system does *not* allocate money to new productive capacity and, instead, allocates it to derivatives, to the bidding up of existing asset prices, to putting individuals, companies and whole societies into debt, to anything but the real economy? Then it is only too clearly seen that the conventional claim of endogenous money for productive capacity is a lie.

And the lie is seen to be worse when it is realised that a government, using the banking system and insisting on market and private property principle, can ensure that *all* of the supply of new money to an economy can go to new productive capacity (in a way which can never be done by the

¹ Margrit Kennedy, *Interest and Inflation-free Money*.

banking system today, indeed, which is incapable of even being understood by the banking system).

Which leaves one other aspect to the conventional claim that it issues endogenous money for the purposes of productive investment. That aspect is interest. Conventional endogenous money bears interest and, very generally, interest *doubles*, or more than doubles, the cost of a capital project. So how can something which *doubles* the cost of a project really be something which causes a “growing from within”? Something that hampers growing cannot be claimed to be promoting growing.

Therefore the conventional claim that only the banking system can issue, and does issue, truly endogenous money for new productive capacity is a lie.

3. Islamic definitions of endogenous and exogenous money

Islam, however, is able to define **endogenous money** quite differently – as state-issued (ultimately from the central bank) interest-free (repayable and cancellable) loans, capable of being administered by the banking system on market and private property principle, which are *always* directed at new productive capacity. A supply of Islamic endogenous money is of immense importance because it is capable of ensuring, among other things:–

- economic and social justice²
- an end to the imposition of interest
- a direct linking of new money to productive capacity
- a widespread ownership of productive capital
- an increase in political freedoms
- an efficient wealth creation
- a basic income for all inhabitants
- policy to unite inhabitants who have different linguistic, religious, geographical and ethnic backgrounds
- an ability of a society to control its own destiny as opposed to being ruled by outsiders and others
- a new economic system which, by a proper use of interest-free loans, spreads productive capacity to all individuals in the population so that they produce (and thus earn) independently of whether or not they also have a conventional job.

In contrast is the Islamic definition of **exogenous money** as *either* money coming from abroad *or* money created by the international banking system operating within a country. The usual form of this money is that of interest-bearing loans which are *not* necessarily directed at productive capacity and furthering the needs of society; and which hand control of society either to a narrow elite or to outsiders.

4. Islamic endogenous money combines efficiency with social and economic justice.

Islamic endogenous money combines efficiency with social and economic justice. Taking the form of state-issued, interest-free loans (administered by the private banking system) it is directly related to the real economy, made repayable and, when repaid, is cancelled or cancellable thus ensuring that productive assets always back a society’s currency. Islamic endogenous money has four main uses:–

² Rodney Shakespeare & Peter Challen, *Seven Steps to Justice*.

Public capital investment thereby allowing hospitals, roads, bridges, sewage works, fire stations, schools etc. to be constructed for one half, or one third of the present cost. Over time, the National Debt would reduce. However, the capital projects can still, if wished, be built by the private sector, managed by the private sector, even owned by the private sector. The key point is that the cost, at the very least, is being halved.

Private capital investment if such investment creates new owners of capital and is part of policy to enable all individuals, over time, on market principles, to become owners of substantial amounts of productive capital. By using state-issued interest-free loans, administered by the banking system on market principles, a company/corporation would get cheap money as long as new shareholders are created.³

Green capital investment, particularly for clean, renewable energy. At present, using interest-bearing loans, a lot of green technology is not financially viable. With interest-free loans, however, it would become viable. Thus we could have, for example, clean electricity through tidal barrages, dams, windmills, wave machines, solar electricity, and geothermal power stations.

Small and start-up businesses thereby freeing them from the crushing pressure of interest-bearing debt. (In the case of small and start-up businesses, there would be no requirement for wide ownership.)

5. Islamic endogenous money implements Say's Theorem (Law)

Neo-classical economics upholds Say's Theorem (Law). The Theorem says that, in a market economy, the total market value of the wealth produced is equal to the total purchasing power created by the process of production and therefore that supply creates its own demand. The Theorem also requires that producers and consumers must be the same people.

But, at present, *there is undoubtedly a huge potential supply which does not create its own demand*. Moreover, producers and consumers are **not** the same people. That is to say, at present, Say's Theorem (Law) most certainly does *not* work in practice.

However, Islamic endogenous money distributes future productive capacity, over time and on market principles, to *everybody* in the population thus ensuring that producers and consumers really are the same people. For the first time in history, the use of Islamic money can ensure that Say's Theorem really does, in practice, become a true Law.

6. A genuine Islamic banking system

Since Islamic loans address all the main aspects of the real economy, the banking system can become genuinely Islamic and have no need to be involved with either the creation of money or the imposition of *riba*.

³ Robert Ashford & Rodney Shakespeare, *Binary Economics – the new paradigm*.

Islamic Money Against The Euro and Dollar

Dr. Masudul Alam Chowdhury

On January 1, 1999, Europe celebrated its momentous event of a single currency for its eleven participating members that have qualified to join the European Monetary Union according to its Convergence Criteria. Following this, it is likely that Britain, Sweden, Denmark and Greece that have either opted out or were not qualified according to the Convergence Criteria at this time, will join by the year 2002. By the year 2002 a single currency called the Euro will become the commercial medium of market exchange in Europe for the participating countries.

I. By establishing a single currency for the exchange of goods and services domestically and internationally, the Euro will become a determining factor of a unified monetary policy, fiscal policy, exchange rate, interest rates, and thereby, also of productivity and technological consequences of these economic changes in the participating countries. Internationally, global capital markets and investment sources will see the rise of two competing currency mediums, the U.S. Dollar and the Euro. Countries around the world will be holding their foreign reserves and transacting their tradable in terms of these two currencies. International currencies will thus become convertible in terms of two competing units.

At such a juncture, the Muslim mind must recount as to what position the Muslim World holds in the midst of the global division of the global division of capital markets between these two competing super currencies? What would be the state of her own resource valuation in the global scene? Do the Muslims have an Agenda for change? If they do have an Agenda for change, what are the constructs of that Muslim future?

II. Until the end of World War II the Western Hemisphere has been engaged in the most heinous kinds of wars and civil strife within itself. Yet through the Bretton Woods Institutions established in 1944, followed by a number of economic and monetary unions between the members of the Western Hemisphere, these same warring nations could rise to a social contract that eliminated wars and political dissensions between them. It was indeed a civil accord enacted within the institution of democracy that did the work for the Western Hemisphere.

The Muslim World—with its teeming millions, vast resources, and above all with the greatest miracle, the Qur'an, along with the guidance of the Prophet Mohammad, Sunnah, the great Islamic legacy of Shura (consultation, discourse and interactions), Ijtihad (epistemological inquiry) and Ijma (consensus), all of which are premised on the exercise of deep Islamic knowledge, tolerance and discourse – could not realize its unity. What are then the structural issues according to which Europe could unite and the Muslims could unite and the Muslims could not?

It will be too shallow an answer to this question to differentiate the Western World in respect to its democracy and the Muslim world as being bereft of democracy. Democracy is a political philosophy that flourishes on the principle of conflict guiding markets in the form of competition and capitalism that thrives on the power of corporations and the acquisitive passion for wealth. Politically, democracy thrives on the back of institutions that master power and hegemony majority rule. Any moral value of doing things and of directing economic resources is sub-directed economic resource is sub-summed within market consequentialism.

There is no other premise from which democracy derives its rules of conduct than the collective power of individuals let loose in a world of competing behaviour. Such is the nature of

individualism that aggregates itself from the level of individuals to institutions, to governments and to the global capitalist order. On such an utilitarian worldview thrives the Western meaning of democracy.

Now take away from democracy the ultimate supremacy of the individual, the powerful lobby groups and thus of governments so formed. We will find that democracy and capitalism weaken into dysfunctional states. With this weakening comes about the collapse of the entire economic, social and political edifice of which democracy, capitalism and western institutionalism confiscate on others to survive.

Thus the imitation of Western democracy is as self-defeating as is the present days' Muslim political vacuity in the absence of a well-defined Muslim social contract. On the other hand, the divide between Islam and the West is based on two polar worldviews that cannot cross lines for a permanent convergence. Any cross-fertilization between the two can only be in terms of mechanical methods that we can share. It can never be in terms of the core methodology of understanding and conducting life in comprehensive ways. When Muslim forgot this subtle difference for a long time now they became blind to the many trappings of Western ways of thinking while being unable to understand this inimical culture, and thereby, being unable to adapt to it. When rulers and demagogues in the Muslim World imitate the Western designs and prevail over their citizenry they try to lock nations into expensive bottlenecks of development costly technological change, unequal distribution of power, deprivation of freedom and rights to masses. Western lobbying is perpetuated through this machinery of autocratic governance as also by the Muslim World's lethargy and subservience to the costly technology, de-equalizing market processes and the concomitant governance of the West genre. To live a day in such inhuman bondage is yet another moment of increased slavery of the Muslim mind body and soul to Western masters.

III. The European Monetary Union on which is premised the Euro was greatly financed by Petrodollars that were held as assets by the wealthy Muslim rulers in EMU. By the same token, when the capital surplus Arab countries bought assets in the International Monetary Fund, they in turn tightened the grips of the IMF over these assets by securing Arab capital in Western capital markets instead of in the Muslim Countries. Consequently, the double whamy fell on the Muslim World. On the one hand, the absence of any expectations for good financial support could not generate the investment climate in the Muslim World. On the other hand there was never enough liquidity available to support investments in the Muslim World. Finally, when global capitalism in its oppressive attire of global governance over markets and institutions entered Muslim countries as speculative short-term capital. These were riddled and driven by interest rate instability and proved to be unsustainable both in terms of projects and in capital markets.

Thus the alienation of the Muslim World from its own fundamental roots of understanding and doing things and its enslavement to the alien culture drifted the Muslim World from its solidarity, which could otherwise have seen the rise of parallels like the Euro and the Dollar in terms of the Islamic Money, Islamic Currency Integrated Islamic Capital markets and a Globally Interlinked Islamic Common Market. Here in would be solved the present days problems of economic instability, currency run-off investment needs, political subservience, inequity and poverty, all of which plague the Muslim World today. Along with this reconstruction would arise the political stability and organization for the spread and practice of Islamic Transformation. Thus would arise the Muslim march toward the Ummah as the Islamic globalization process.

The Islamic globalization process of Ummah as the goal of the Muslim World would look at markets in ways contrary to the capitalist greed and human deprivation now being unleashed upon

the Muslim World. The irony is abhorring that in the face of exorbitant wealth possessed by a few wealth that lies in the hands of and are controlled by Western masters, there continues to be abject deprivation and impoverishment among the majority of Muslim population.

Islamic Money would be based on the 100 percent reserve requirement linking monetary valuation with real sectoral activities and not with speculation or promissory notes. The productive yield arising from such a real monetary mobilization would solve the problem of low productivity among factors of production. The participatory enterprises in the midst of these transformations and real monetary linkages would remove the relevance of interest rates. Such a system would replace interest transactions with resource mobilization into participatory enterprises. Consequently, economic efficiency, distributive equity, ownership, property rights and empowerment would increase across participatory enterprises. Poverty would be eradicated and alleviated through the force of such participatory entrepreneurial activity and by the direct linkages between money and real sectorial activity.

This freedom of participatory decision-making and ownership of assets would mean the rise of the Islamic Social Contract based of the process of Shura (discourse and interaction) which is organized and realized by the understanding and application of the Precept of Unity of Allah (Tawhid) in all walks of life and thought. Such a focus will turn away the Muslim global order from the anthropocentric character of conflict, competition and individualism that grounds democracy as a political philosophy in the West. the reversal will instead be towards ethical governance of markets and exchange under the enlightened process of learning by doing by discourse, complementary and integration as created by Islam.

The Islamic Common Market and the Islamic Capital Market would be a global integration of various regional Islamic blocks on the basis of the coordinating mechanism of the Islamic Social Contract in terms of the money real sectoral linkages, inter-communal trade and institutional guidance of these across the Muslim World be the formation of the Islamic currency revolving around the financial and economic instruments that establish the money real sectoral linkage. Thereby, an increase of spending in the Islamically recommended good things of life would create the environment of abundance in life-fulfilling foods. This in turn would generate income and wealth from real returns.

The bullion of speculation and its replacement by long-term Islamic investments in diverse Islamic opportunities, complementary possibilities and technological outlets, in government and consumer spending across the populous Muslim World, will bring about the much needed stability in markets for financial instruments and real goods and services. Hence a productivity linked stable exchange rate will emerge from such a stable market order. The enhancing effects of stable exchange rates and prices will revert to further resource mobilization, wealth, growth, development and social well-being.

Zakat will arise from the growing wealth of such a dynamic social economy and would be increasingly channeled into productive outlets for ameliorating the poor and guaranteeing them human resources and basic needs. Institutions for mobilizing Zakat as an international resource will create micro enterprises and human resource development for poverty alleviation. The great institutions of social well-being based on the mobilization of Zakat into human development for achieving security, dignity and productive transformation of the recipients, while always allocating a part of it in current consumption, for the destitute, the sick and the old, would generate industry and enterprises around such uses of the Zakat Fund. Gross unemployment and income disparity will thus be eliminated. With social security thus returning to the Muslim nations, social malaise will also decline. Much will be saved for directing into the higher pursuits of life.

With such momentous changes in the Muslim World towards the Ummah, the Dollar and the Euro will prove to be weak currencies before the Islamic Money and Islamic Currency, for they will continue to be engulfed in instability caused by interest rate movements. These will permanently disturb their currency values. The Dollar and Euro will thus continue to be simply monetary units governed by uncertain interest rate and exchange rate mechanisms. Monetary policy will remain independent of real sectoral activities. Price movements will thus be affected by the uncertainties ensuing from the monetary sector. Such an adverse effect of the monetary sector on the real sector will cause instability in both the real and the financial sectors.

Such instabilities will remain as the great predicament of the Euro and Dollar the contrary is true of a competing monetary system and its currency that can deliver a 100 percent reserve requirement while interconnecting money with real sector activities. Here then lies the ultimate financial architecture by means of Islamic Money, Islamic Currency, Islamic Capital Market and Islamic Common Market. These mark the worldly model of the Ummah. In it the lure for wealth is strategically replaced by the goals of production and distribution of wealth through the money-real sector linkages. This abolishes interest rates from economic transactions and premises human well being on resource mobilization into Islamic possibilities.

Let Muslim around the world nationally, sub-nationally and collectively take up serious work in this direction of Islamic Transformation toward the Ummah in the new millennium. Let this invocation remain our Ramdhan. Resolution 1419H for its active emulation into the new Islamic millennium. May Allah help us in our rightful endeavour.

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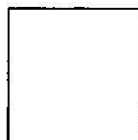
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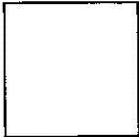


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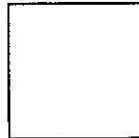


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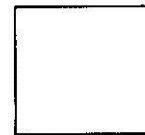
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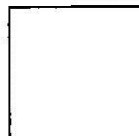


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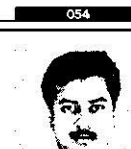
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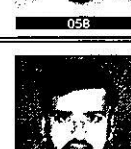
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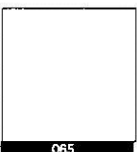
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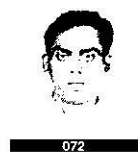
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Program Schedule

INTERNATIONAL SEMINAR ON
*Harmonizing Development And Financial Instruments
By Shari'ah Rules For Ummatic Integration*

*Safa Arcade, Chittagong, Bangladesh
Sunday-Monday, December 19-20, 2004*

Jointly Organized by

The Center Of Comparative Political Economy (CCPE)
International Islamic University Chittagong (IIUC)
&
World Assembly Of Muslim Youth (WAMY)

The Ummah (hence Ummatic) is the conscious world nation of Islam. It reflects the Muslim World's understanding of globalization by the Islamic synergy. This unique international conference will be of interest to all who are seriously interested in a mix of academic and practitioner views on economic and financial integration of the Ummah using diverse approaches of policy harmonization and program linkages at various levels of Islamic financial and economic undertakings. The focus is on a mix of conceptual reasoning and its application toward realizing desired levels of co-ordination and harmonization of Islamic financing and development perspectives using the Shari'ah.

The objective of this International Conference is to bring together some selected Islamic financial institutions and leading academicians in the field of Islamic finance, economics and the Shari'ah to discourse on the following pressing questions:

- How can the programs, policies and development perspectives of the Ummah be organized, harmonized and sustained in the light of the framework of Ummatic transformation?
- How can a real Ummatic globalization of the Muslim World be so realized?
- What are the conceptual issues that interface with the real issues of Ummatic re-emergence in today's modern and global world?
- How can existing and new Islamic instruments be further developed and harmonized by Shari'ah rules to achieve Ummatic transformation?

Chairs, presenters and discussants are advised to allow forty minutes for general questions-and-answers sessions.

BUSINESS SESSION-3: 6:00 – 8:00 PM [60min = papers: 15min = discussants: 40min = question-and-answer session]

Money, finance and real economy linkages

Chair : **Professor Dr. Masudul Alam Choudhury**
School of Business, University College of Cape Breton, Sydney, N.S. Canada
Director General, CCPE, IIUC &
International Chair, PPIEF, Trisakti University Jakarta, Indonesia

PAPERS

Keynote paper : **Dr. Ahamad Kameel Mydin**
Faculty of Economics, International Islamic University Malaysia, Gombak, Malaysia.
The seigniorage of fiat money and the Maqasid al-Shariah: The unattainableness of the Maqasid

Papers : **Dr. Moussa Larbani**
Faculty of Economics, International Islamic University Malaysia, Gombak, Malaysia.
The seigniorage of fiat money and the Maqasid al-Shariah: viability of the Gold Dinar

: **Abd. Ghafar b. Ismail and Ismail b. Ahmad**
Islamic Economics and Finance Research Group School of Economics, UKM, Malaysia
Does the Islamic financial system design matter?

Discussants : **Professor Dr. Zuhurul Huque**, Finance Department, Chittagong University.
: **Professor Gholam Mohiuddin**, Finance Department, Chittagong University.
: **Mr. Abdul Awwal Sarker**, Deputy Director, Bangladesh Bank Research Department.

QUESTION-AND-ANSWER SESSION

DINNER : **8:00 PM**

Dinner Interlude : **Professor Dr. Sofyan Syafri**
Director of the Postgraduate Program in Islamic Economics and Finance (PPIEF) At
Trisakti University Jakarta Indonesia
: **Professor Dr Masudul Alam Choudhury**
International Chair of PPIEF
&
: **Dr. Yuswar Basri**
Deputy Vice-Chancellor of Trisakti University Jakarta

Introducing the Postgraduate Program in Islamic Economics and Finance (PPIEF) at Trisakti University Jakarta Indonesia

SUNDAY, DECEMBER 19, 2004

OPENING SESSION: 9:30 – 11:00 A.M.

- Chair** : **Professor Dr. A.K.M. Azharul Islam**, Vice-Chancellor, IIUC
- Chief Guest** : **Mawlana Motiur Rahman Nizami**
Honorable Minister, Ministry of Industries
Government of People's Republic of Bangladesh.
- Guest of Honor** : **Mr. Murad Abdul Hadi Shahin**, Director, WAMY-Bangladesh Office.
: **Alhaj Badiul Alim**, Secretary, IUCT

BUSINESS SESSION-1: 11:15-12:45

- Chair** : **Professor Dr. A.K.M. Azharul Islam**, Vice-Chancellor, IIUC
- Keynote Lecture** : **Professor Dr. Masudul Alam Choudhury**
School of Business, University College of Cape Breton, Sydney, N.S. Canada
Director General, CCPE, IIUC
&
International Chair, PPIEF, Trisakti University Jakarta, Indonesia

INTRODUCING THE THEME:

The Dynamics of the Shari'ah and World-System

LUNCH & SALAH: 12:46 – 3:00 P.M.

BUSINESS SESSION-2: 3:00 – 5:00 P.M. [60min = papers: 15min = discussants: 40min = question-and-answer session]

Some conceptual and practical aspects of development planning in the Islamic framework

- Chair** : **Professor Dr. Abu Bakr Raqfique Ahmad**, Pro-Vice Chancellor, IIUC

PAPERS

- Keynote Paper** : **Mr. Pervez Nasim, Chairman**, ISNA Co-Op Housing, Toronto, Ontario, Canada.
Key Concepts Of Islamic Finance And A Case Study On Islamic Co-Operative Housing Corporation Ltd.

- Papers** : **Mr. Muhammad Iqbal Anjum**
The International Institute Of Islamic Economics, International Islamic University, Pakistan
Globalization at crossroads of warfare, revolution, and universalization
- : **Dr. M. Shahadat Hossein**, Department of Computer Science, CU, Bangladesh.
A development planning application of relational epistemology and tawhid.

- Discussants** : **Professor Dr. Syed Mohammad Ather**
Dean, Faculty of Administrative Sciences, IIUC
- : **Professor Harun ar-Rashid**
Finance Department, Chittagong University

QUESTION-AND ANSWER SESSION

REFRESHMENT AND SALAH: 5:00 – 6:00

MONDAY, DECEMBER 20

BUSINESS SESSION-4: 9:00 – 11:00 AM [60min = papers; 15min = discussants; 40min = question-and-answer session]

Harmonizing financial instruments by social networking

Chair : **Prof. A.J.M. Nuruddin Chowdhury**, Vice-Chancellor, Chittagong University

PAPERS

Keynote paper : **Professor Dr. Sofyan Syafri**
Faculty of Economics & Management, Director of the Postgraduate Program in Islamic Economics and Finance (PPIEF) Trisakti University Jakarta, Indonesia.
On the experience of Islamic banking in Indonesia

Papers : **Dr. Abul Hassan**, Markfield Dawa Center, The Islamic Foundation Leicester, UK.
Networking: Islamic social capital, development and the role of formal and informal institutions

: **Dr. Muhammad Nurul Alam**
Assistant Professor of Accounting Sultan Qaboos University
The influences of 'Societal Sector Institutions' in promoting lender-borrower network relationships between Islamic Banks and small and cottage industry owners (A study based on the Islamic Banking Finance to rural-based small and cottage industries in Bangladesh)

Discussants : **Professor Dr. Borhan Uddin**, Director, School of Business, IUB
: **Mr. Zahurul Islam**, Finance Director, Open University, Bangladesh

QUESTION-AND-ANSWER SESSION

REFRESHMENT : 11:00 – 11:30 A.M.

BUSINESS SESSION-5: 11:31-1:30 PM [60min = papers; 15min = discussants; 40min = question-and-answer session]

Islamic financing for growth and development

Chair : **Professor Dr. A.H.M. Sadeq**, Vice-Chancellor, Asian University of Bangladesh.

PAPERS

Keynote paper : **Professor Abd. Ghafar b. Ismail & Nur Azura bte Sanusi**
Islamic Economics and Finance Research Group, School of Economics, UKM
Financial intermediation and economic growth: an empirical investigation

Papers : **Dr. Badr El Din A. Ibrahim**
Economic Expert, Ministry of Finance, Sultanate of Oman, Muscat, Oman.
The 'missing links' between Islamic development objectives & the current practice of Islamic banking with reference to the Sudanese Islamic banking experience

: **Professor Abdul Mannan Chowdhury**, Department of Economics, CU
Integrating the presented lectures in the light of the conference theme

Discussants : **Dr. Yuswar Basri**, Deputy Vice-Chancellor, Trisakti University Jakarta, Indonesia
: **Dr. S.M. Ali Akkas**, Joint Chief, Ministry of Women & Children Affairs, GOB

QUESTION-AND ANSWER SESSION

LUNCH & SALAH : 1:31 – 2:30 PM

BUSINESS SESSION-6: 3:00 – 5:00 PM [60min = papers: 15min = discussants: 40min = question-and-answer session]

Social accounting and Islamic insurance

Chair : **Professor Dr. Muhammad Loqman**, Chief, IIUC, Dhaka Campus

Papers : **Professor Sofyan S. Harahap**
Department of Economics & Postgraduate Program in Islamic Economics and Finance,
Trisakti University Jakarta, Indonesia.

Masudul A. Choudhury, UCCB

&

Dr. Yuswar Basri.

Social accounting in Islamic political economy

: **Professor Dr. Abu Bakr Rafique**, Pro-Vice Chancellor, IIUC

Insurance: an Islamic paradigm

: **Professor Dr. Mohammad Solaiman**, Dean, Business Faculty, USTC, Bangladesh

Integrating the presented lectures in the light of the conference theme

Discussants : **Mr. M. Tajul Islam**, Vice-Chairman, Far East Islamic Insurance Co. Ltd.

: **Mr. Mujahidul Islam**, Associate Professor, Department of Finance, D. U.

: One representative of WAMY

QUESTION-AND-ANSWER SESSION

REFRESHMENT & Salah: 5:00 – 8:00 P.M.

DINNER-KEYNOTE LECTURE AND FINALE : 8:00 PM

Chair : **Professor Muinuddin Ahmad Khan**, VC, Southern University of Bangladesh

Speaker : **Mr. Rodney Shakespeare**, Global Justice Movement of Global Talk, London, UK.

Islamic endogenous loans

SIGNING CEREMONY of MoU

BETWEEN

Postgraduate Program in Islamic Economics and Finance (PPIEF)

Trisakti University Jakarta, Indonesia

And

International Islamic University Chittagong

Vote of Thanks : **Director**, WAMY Bangladesh.

Concluding Remarks : **IIUC Representatives**

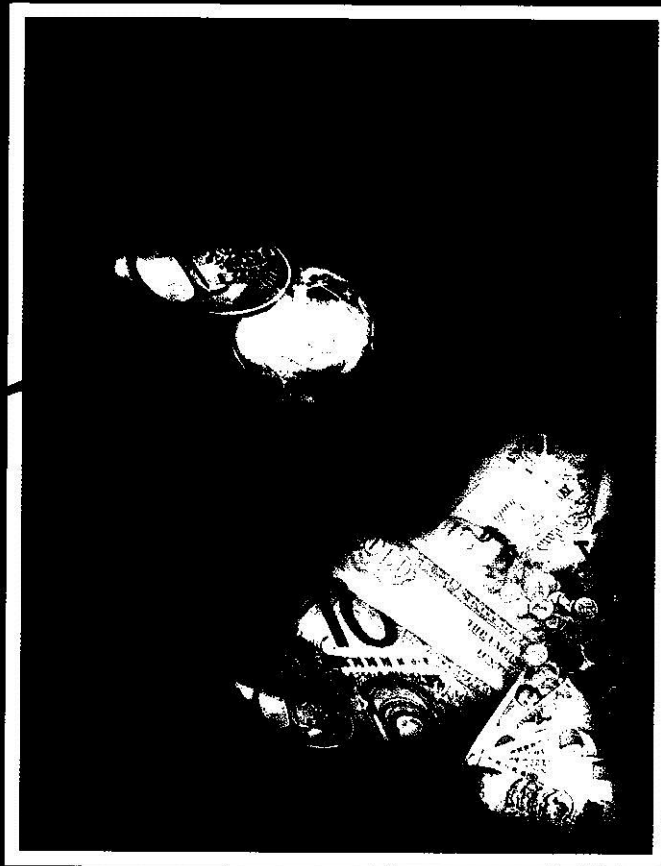
: **Professor Dr Masudul Alam Choudhury**

Financializing Development
of Financial Instruments

by

Dr. Md. Wajid Faruq for Thematic Integration

| Souvenir & Proceedings of Papers |



International Islamic University Chittagong (IIUC)
World Assembly of Muslim Youth (WAMY)



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