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THE UNIVERSITY

The International Islamic University Malaysia (IIUM) was established by the Government of Malaysia in 1983. Since then it has been expanding on all fronts and is now offering degree programmes in Islamic Revealed Knowledge & Heritage, the Human Sciences, Economics, Management, Laws, Engineering, and Medicine. It is also planning to open soon other programmes of study such as Architecture & Environmental Design. The student population has rapidly grown to over eight thousand representing more than 80 countries. The students and faculty truly represent an international character. The University, while trying its best to attain the goals of excellence and commitment, regards knowledge as a trust from Allah, to be utilized in accordance with Divine Will. Accordingly, the quest of knowledge is regarded as an act of worship. This philosophy of knowledge and education is based on the recommendations of the First World Conference on Muslim Education held in Mekkah, Saudi Arabia in 1977.

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The Kulliyyah (Faculty) of Economics and Management Sciences was established in the same year as the University in 1983. Currently, the Kulliyyah offers undergraduate programmes in Economics, Business Administration, and Accounting, leading to the Bachelor of Economics, Bachelor of Business Administration and Bachelor of Accounting degrees respectively. It also offers Master's in Economics. However, the Management Center of IIUM separately administers Master's in Management, Executive MBA and Diploma in Islamic Banking.

NOTES TO CONTRIBUTORS

Aims & Scope of the Journal

The *IIUM Journal of Economics and Management* (JEM) is an internationally refereed journal published twice a year by the Kulliyyah (Faculty) of Economics and Management, International Islamic University, Malaysia. In line with the objectives of the Kulliyyah and the University, the Journal is dedicated to the development, promotion and understanding of Islamic Economics in its widest sense, including issues related to management and accounting, in order to keep scholars and relevant institutions informed on research in the field of Islamic Economics.

Based on the Islamic worldview concerning God, man, nature and the concept and purpose of religion, this Journal promotes the idea that economic activity cannot, but be a part of *al-d¬n,* and must be guided and developed within the twin epistemological foundations of revelation and reason. In the Islamic worldview, the former portrays the ultimate foundation of *tawḥ¬d,* while the latter acknowledges the intellect of man irrespective of religion or colour. While ackowledging the great strides in conventional economics, the Journal is committed to the idea that ultimate solutions to human problems cannot be sought without reference to revelation and the Divine.

Within this framework, the Journal focuses on theoretical, applied, methodological and interdisciplinary works dealing with historical or contemporary economic issues.

The editorial board welcomes original submission in the areas of Economics (including relevant *fiqh* deliberations), Management and Accounting to cover historical and case studies, as well as methodological, conceptual, theoretical, analytical and applied issues. Apart from discussions from the Islamic perspective, articles can also be of the conventional sense, preferably pertaining to Muslim countries for case studies. The Editorial Board also welcomes book and article reviews of materials which are originally written in languages other than English.

Submission of Manuscripts

Manuscripts and editorial communications should be addressed to the Editor, IIUM Journal of Economics and Management, Kulliyyah of Economics and Management, International Islamic University, Malaysia, Jalan Gombak, 53100 Kuala Lumpur, Malaysia. Articles should be sent in three (3) copies and should generally be no more than 8000 words. Each manuscript should have a title page and an abstract of about 150 words. The title page should contain the title, full name(s), designation(s) and organizational affiliation(s), and one contact address. Articles are received on the understanding that they are not under concurrent consideration at another journal. Exclusive copyright of accepted manuscripts shall be assigned to the Publisher, and in consideration for this, two copies of the Journal and ten complimentary offprints will be provided for each article.

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Articles should be typed in double-space (including footnotes and references) on one side of the paper only (preferably A4) with wide margins. Footnotes should be numbered consecutively and placed at the end of the manuscripts. As far as possible, footnotes should be kept to a minimum. Tables and diagrams should be provided on separate sheets at the end of the manuscript and their positions indicated in the text. Authors should consult the *Chicago Manual of Style* for text and citations when preparing papers for submission to the Journal.

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Books: Siddiqi, Muhammad Nejatullah. *Partnership and Profit-Sharing in Islamic Law*. Leicester: The Islamic Foundation, 1985.

Periodicals: Geske, R. "The Valuation of Corporate Liabilities as Compound Options." *Journal of Financial and Quantitative Analysis* 12 (1977): 541-52.

All foreign words must be typed and transliterated. The Editorial Board reserves the right to change the transliteration of all historical names, titles and non-English terminology to bring them into conformity with its own style.

Use of Mathematics

Mathematics should be used only when necessary and the conclusions derived must be explained and made intelligible to a non-mathematical reader. Wherever possible, authors are encouraged to place the mathematical parts of the article in an appendix. In cases of empirical articles, authors are expected to make readily available a complete set of data and any specialized computer programs to interested readers.

Refereeing Procedure

Articles will be acknowledged upon receipt and will be read by two expert reviewers in addition to the editors. Editorial decision will normally be made within six (6) weeks, but circumstances beyond control occassionally dictate a longer cycle. If authors are invited to prepare a revision for further consideration, the major issues to be resolved will be outlined and will be forwarded to them as quickly as possible.

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ISLAMIZATION OF KNOWLEDGE IN ECONOMICS: ISSUES AND AGENDA

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Abstract

This paper discusses three issues — worldview differences, revelation-reason relationship, and the question of methodology — important for Islamizing knowledge in the field of economics, and presents also the outlines of an agenda for action. Western worldview separates the mundane from the spiritual aspect of human existence while Islam keeps the two unified. This makes the goals, scope, and principles of secular economics in many ways different from those of Islam in the area.

Reason alone is the basis of theoretical formulations in secular economics. Islam too encourages people to use intellect for analyzing observations and draw inferences to discover the truth but within the confines of the *Shar¬cah*: reason is not allowed to violate revelation. Evidently, procedures priorities, and prescriptions, can rarely be the same in the Islamic as in secular economics.

Methodology of secular economics essentially is a posterior development. It has invariably sought to rationalize what economists have actually been doing over the centuries so as to fortify the evolving doctrine of free enterprise. In contrast, for Islamic economics the doctrine was already contained in the revelation. To discover — not to invent — has been and remains the task of methodology in Islamic economics. Unlike the secular dispensation, the glide here is from methodology to economics, not *vice versa*. The agenda outlines focus on considerations in preparing reading materials, and in developing curricula.

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1. Introduction

The prime aspiration of the Muslim *ummah* after the Second World War has been to hasten the restitution of Islam's past status and glory at the global level. An important plank of the effort to achieve the end has been the Islamization of human knowledge, especially since the late Al-Far,q¬ presented his ideas on the subject way back in 1982.[1] Indeed, his programme is still viewed as *the* key for unlocking the doors of real progress and prosperity on the decadent Muslim societies of today.[2]

Islamization of knowledge has been a cardinal theme for discussion at the international conferences and local seminars. Various institutions, the International Institute of Islamic Thought (IIIT) in particular, university departments, research centers, state agencies, non-governmental organizations, and individuals all remain seized with the problem. Even so there is a growing perception, which this author shares, that Islamization of knowledge has barely taken off the ground, and there is urgency to increase the pace. It is in this context that the present paper looks at the case of economics for a variety of reasons.[3] It seeks to clarify some of the basic theoretical issues in the area, and also outlines an agenda for action.

As a preliminary, it may be noted that economic events are interwoven in a political, legal, moral, and ideological pattern with each element influencing the other. The pattern keeps on changing, and commits all social sciences, including economics to a sort of evolutionary holism. A purely economic analysis must pose as it does serious demarcation problems.[4] This fact is well acknowledged but is invariably ignored in economic writings. Again, even as much of the discussion in the secular area is characterized with increasing conflict, and confusion,[5] there remains a remarkable agreement among the economists on an issue of importance. They are almost unanimous in the opinion that value judgments cannot be admitted into economics unless they meet the criterion of 'objectivity.' Common reasoning and evidence or *positive* economics is considered to be the surest means to resolve normative disputes.[6] Of late, this view seems to be dissolving into the new current of thought, but textbook economics is still not willing to relent on the issue.[7]

Thus, the secular economics literature rarely accords significance to the holistic nature of the social dynamics, and insists on defining the 'normative' within the limits of human reason. Both are the issues relevant to our main theme, and we may return to them later. What is important for now is the question: What do we mean by Islamization of knowledge? A brief but clear explanation of the phrase is needed to understand its scope and implications.

The views on the point are blurred, but two shades of thought are presumably discernible. First, there is the view which adopts what may be called an all-or-nothing approach to the process of Islamization. It insists that Islamic economics must not brook any intrusions that the classical interpretations of the *Shar¬cah* cannot accommodate. Here, the basic assumption is of a performing Islamic society being in existence. Islamization here results in producing pure economic models. In contrast, the second view looks at things in a rather pragmatic frame. It prefers a step-by-step movement towards the ultimate in an evolutionary manner. It seeks to progressively modify the existing secular structures, and advocates for reopening doors of *ijtih®d* in the light of modern needs, and compulsions. Both approaches are, in fact being pursued, and are useful, in the development of Islamic economics. Pure models may look sterile, but they do help, as in secular economics, identify the relevant variables under complex social situations, highlight their relationships, indicate the direction of movement and unveil important policy implications. An evolutionary approach is obviously much more appealing. In fact, this approach to Islamization of knowledge is as old as Islam itself. For, Islam started, though with a rejection of what was inconsistent with its tenets — anyone who embraced the faith had to immediately cut off from the *j®hiliyyah*, the state of awareness (knowledge) ignorant of the guidance from God[8] — it is well to note that even then not a few concepts, trade practices, and previous economic ideas not in line with the Islamic ideas were retained for the time being with or without modifications. The resurgent Islam finds today the same sort of polluted knowledge dominating the world, Muslims included. The process of Islamization may take this knowledge in manageable segments in the same vein: it can be sifted, pruned, and modified, where possible, to conform with the *Shar¬ᶜah* tenets. In other words, we may retain in economics, as elsewhere, those valuable parts of secular knowledge which do not defy the *Shar¬ᶜah*, and modify or reject those which do. Broadly, it is this approach to Islamization which is currently popular in Islamic disciplines including economics.

This approach is somewhat alluring. It makes research easier; introduce in a suitable main stream economic construct any of the *Shar¬ᶜah*'s behavioural norms, *zak®t* payments, zero rate of interest, and profit-sharing ratio or their relevant mix, for example, and an apparently impressive Islamic model is ready at hand. Islamic economists mostly consider these four as the more relevant variables for designing an economy of their vision. But the difficulty is that models thus erected remain reflective of their parent structures' worldview, norms, and methodology. The pitfalls must make us understand that we are not so much in need of Islamizing knowledge as of *creating* Islamic knowledge.[9] In the latter case, one can still take advantage of the mainstream tools, postulates, and positions to the extent that they do not violate the *Shar¬ᶜah* norms, but creation insists on a positive change in attitude.

Disciplined knowledge is science which is a sort of man's cognitive enterprize.[10] The issues which concern science are of epistemic import. They belong to the philosophy of science, largely a part of the theory of knowledge. It deals with these issues under the subject of methodology. Mainstream economics has of late attracted much attention of the philosophers, ironically though, the relevant issues have become all the more entangled. On the other hand, one finds that philosophical discussions concerning Islamic economics are few, illuminating ones even fewer.[11] The following section which deals with the issues including the worldview differences, revelation-reason relationship, and methodology, takes special note of the matter. The idea is to provide a feel of the nature of Islamic economics, and its main points of departure from its secular counterpart. Section three deals with some of the factors impeding the progress of Islamic economics as an academic discipline, and presents the outlines of an agenda for action. Section four collects the main points of the foregoing discussion, and makes a few concluding remarks.

Finally, the paper deals with issues concerning the process of Islamization of knowledge; however, it does not seek to evaluate its progress or performance. Also, the analysis is mainly based on the literature available in English. But this need not detract from the depth and range of the argument. For the leading Islamic economists, writing on the subject in other languages, more so in Arabic, mostly are the same as contributing to it in English. Their views, and positions are generally well-known to different language users.

2. The Issues

The worldview underlying any social system makes it what it is in all its ramifications. In the field of knowledge, including economics, it latently specifies the cognitive medium, the ontological positions, the methodological rules, the behavioural norms, the value frame, and the like. The essential distinctions between the two economic disciplines — secular and Islamic — primarily arise due to differences in these specifications. Accordingly, it is better to start our discussion with a brief comparison of the worldview conditioning the two disciplines. It may be noted that the concept of worldview in Islam is of an all embracing sort. For that reason, some writers do discuss the reason-revelation relationship and questions of methodology as part and parcel of the same issue, but not a few treat them separately for a variety of reasons. We prefer to follow the latter for our purposes.

2.1 Worldview Differences

Western in origin, the notion of a worldview is contextual. We cannot explain it without specifying whose worldview we are talking about, at what point in time, and for what purpose. Discussions on the subject often refer to the individual's perception of the world, though the role external factors play in shaping the same is recognized.[12] But then we are likely to have almost as many worldviews as the number of individuals in a society. Such a wide diversity cannot make for the thrust and content of knowledge in a discipline. For this purpose, we have to look at the worldviews the different social systems rest on and attempt to promote. Individuals can still have their own variations, but their average behavior would tend to conform to the norms of what has socially been agreed.[13]

Under the influence of education (including religious) and environment, individuals in a community develop, rather unconsciously, a shared mental image of God's creation and its purpose, i.e., of men's place and role in the universe, and of their relationships with the social phenomena by which they are influenced, and which they influence. Such a collective mental image constitutes the society's worldview. It is an architechtonic whole from which various human activities in general follow. Islam provides man with a worldview shaped by revelation which is flexible but not replaceable. On the other hand, the West has what it calls a 'scientific' worldview based purely on human reasoning and changeable almost at will. Both these versions have their own approaches to the material and spiritual aspects of human existence. Also, both create their own visions of truth and reality.

Islam inculcates in man a perception of his own significance in the universe.[14] The *Qur'®n* tells us that man is the best of all creation, even superior to angels. He is a combination of earth and divine spirit, and is gifted with the attributes of consciousness, discretion, and creativeness.[15] God made him His vicegerent on earth: His trust-keeper and co-worker. He stocked the earth (and heaven) with His inexhaustible treasures and made them submit to be worked up by man for his use and enjoyment.[16] However, man has to run his affairs in the world on the terms and conditions of the Trust as laid down by its Creator and enshrined in the *Shar¬cah*. He will be accountable in the hereafter for his deeds here, getting reward for following the prescribed norms of behaviour, and punishment for their violation (*Qur'®n* 2:38-39). Thus, from its very inception, Islam is a man adoring religion: it empowers him to enjoy life in this world and teaches him, if he cares, to do so in a way that the pleasures in the hereafter also remain open to him.

In other words, the Islamic worldview links inseparably the life in this world (*al-duny®*) with the life in the hereafter (*al-®khirah*), the latter being of ultimate significance. The *duny®* aspect of human life is seen as a preparation for its *®khirah* aspect. "Everything in Islam is ultimately focused on the *®khirah* aspect without thereby implying any attitude of neglect or being unmindful of the *duny®* aspect."[17] The notion centers around the Islamic concepts of *tawh¬d*, vicegerency, and *al-ᶜadl*.[18]

A worldview is evolutive, and is locked in a two way relationship with knowledge. The formation of the Islamic worldview to its maturity followed the course of revelation over time. During the process, and after, it shaped the content, and direction of the growing disciplines — science, jurisprudence, *tafs¬r* (interpretation), *kal®m* (philosophy), literature, history, economics, and others — during the commanding centuries of Islam. But to what extent the growth of knowledge over time affected, or can be allowed to affect in future, the Islamic world view are questions on which opinion remains divided.[19] However, there is a sort of consensus about a 'hard core' concept, akin to the one in Imre Lakatos's Methodology of Scientific Research Programmes or MSRP,[20] which the impact of growing knowledge in any discipline cannot be allowed to dilute or violate.

We call it the 'hard core' because it provides the Islamic answer to an eternal question — the question of faith with two aspects: the divine and the human, and the nature of relationship between them. Thus, its main elements are explanations concerning the attributes of God, the nature of revelation, the purpose of man's creation and his place in the universe, the faith imperatives, the notion of justice, and the meaning of reality and truth (*Qur'®n* 31:30). These elements and the terms and implications they unfold have a profound bearing on the Islamic ideas about change, development, and progress.[21] They all have been, and remain open for interpretation, and elaboration among Muslim scholars but within restrictive confines.

Islam's economic frame is inlaid with its above described worldview. Since Islam is not a 'theory' based on assumptions but a 'way of life' dealing with 'actualities,' orthodoxy prefers to talk of an Islamic economy or system rather than economics. We may use the terms here interchangeably.[22] An Islamic economy has some distinctive features of wide import. Property ownership constitutes a right restrained by responsibility.[23] Financial arrangements have to shun all forms and shades of interest. Business transactions must remain free of *ghar®r* (indeterminacy). Market cannot be an instrument of any sort of exploitation. Profit carries a much wider meaning than it has in customary accounting. Establishing social balance, equity, and reciprocal responsibility is a fiscal policy imperative. Basic needs fulfillment is a growth priority. Social gain has preference over private benefit, cooperation over competition. And there are no barriers to the Islamic state's intervention in economic matters if unavoidable for promoting the *Shar¬ᶜah* objectives.[24] The Islamic approach to economics is holistic, and it centers around its all pervading concept of *am®nah*.[25]

It is not that economics as a formal discipline wears the religious garb in the resurgent Islam for the first time. In fact, secular economics could not completely free itself of the Christian bearings until barely a century earlier.[26] The alienation process, starting with the Enlightenment movement, perhaps culminated in a total separation of the two only when in 1929, the Vienna Circle published a position paper called the "Scientific World-View."[27]

What initiated this development was a new set of ideas, the rising businessmen with significant political clout needed to help remove the lingering feudal institutions and the restrictive controls of the mercantilist era. Ancient truths such as the immorality of interest, the virtues of charity, and the contentment with one's inherited station in life were considered barriers to progress, and had to be removed. For all this, economists found the revolutionary ideas and methods then characterizing natural sciences much fertile and welcome. Newton's science provided a nature as effective as was the earlier will of God. "If the Divine Will had created a mechanism that worked harmoniously and automatically without further interference, then *laissez faire* was the highest wisdom in social affairs. Natural laws would guide the economic system and the actions of people."[28] Adam Smith articulated the pursuit of self-interest as the natural law for economics and held that it was in harmony with social interest.[29] He saw great spontaneity in the evolution of economic institutions like division of labour, money, and capital accumulation.[30]

The legitimacy of *laissez faire* as derived from the natural order illustrated by the solar system in Newton was reinforced by the key ideas of Darwin — the struggle for existence, natural selection based on individual differences, the survival of the fittest, and the evolution of species — which led social scientists to natural order from the biology end. "Both ideas accepted the environment as given and not to be manipulated or changed; both ideas were suitable for those who had no basic grievance against the existing order."[31] Interestingly, what was natural was thought as beneficent and just also.[32] Again, even though in social sciences, including economics, a relativistic outlook developed independently, there is room for presumption that Einstein's theory of relativity — what is true for an observer in one system may not be true for an observer in another system — had an inspiring effect. The development of such terms as "frame of reference," "value system" and "point of view" are illustrations of the influence.

The impact of the three revolutions in natural sciences induced major changes in social sciences both in thought and practice. Indeed, many, including Popper, clearly advocate "a unity of method among all disciplines and a 'naturalistic' view that rejects any telling difference between the social and natural sciences."[33]

In what way the 'unity of science' gospel affected economic theory and method we shall see later. Of concern at present is the separation it enforced between religion and ethics on the one hand and social sciences on the other. The separation was intended to expel from their purview all transcendental ideas to promote a scientific worldview, especially for economics. These ideas were attacked with a skeptical scalpel as they were believed to constitute the illogic of trying to deduce evaluation and prescription from analysis and description: in short, an 'ought' from an 'is.'[34] Science, it was asserted, dealt with 'is' alone, and could accommodate 'ought' only when supported by objective logic. Thus the scientific worldview thought of the universe as a self-acting machine following the natural laws, even when God remained its original creator. It restricted man's vision to his existence in this world without any thought of the hereafter. It relied on reason alone as a tool for explanation and inquiry.

Thus the so-called scientific worldview essentially projects rationalistic materialism reflecting and caring for only the mundane desires of man. It sees the universe merely as a source of material requisites of well-being. It takes the sky as devoid of any feeling, sense, and divine power. Man does not find any meaning in existence: he feels existing because he exists. In the absence of the hereafter and accountability to any supreme being, he hardly sees any difference between an act of suicide and a feat of sacrifice as, to him, there is no system for ultimate reward and punishment.[35] Here, the exclusive focus is on the materialistic component of human existence, the spiritual and moral component being taken care of, if at all, by ethics or religion.

In Islam, the matter-spirit interlock in man's personality would rarely allow him to follow either asceticism or mammon worship. But once the two were separated by the Enlightenment in the West, capitalism never permitted them to rejoin. Economics overpowered human thought and action to the exclusion of ethics. The scientific vision capitalism promoted awakened the body, slumbered the soul. It tailored Christianity for perpetuating itself, locally and internationally, as a logical and credal system. In fact, what the Vienna Circle advocated for was not a 'scientific' but a loaded worldview that took society along a route dominated by materialism. The achievements of modern capitalism on this path have, indeed, been glorious.[36] But unfortunately "it went far to replace quality with quantity, intuition with reason, search for truth with search for power, life for the sake of an ideal with life for the sake of life . . . and so on. Beauty, truth, and charity — the three most cherished, lasting values in human culture — were dismissed and in their place were installed the three popular principles of capitalism: realism, power, and consumption."[37]

Material progress, unrestrained by ethics, has been achieved at an incalculable cost to society in terms of environmental damage and human suffering, especially spiritual. Fragmentation of the unitary religious worldview in the name of science made the capitalists the dominant social class to which belongs power, wealth, and even clientele religion in a dualistic setting.[38] The process of Islamizing knowledge must restore the unity of its worldview which the alien influences dismembered in the Muslim mind as well. Required for this is, above all, a closer look at the "relationship between revelation and reason," an issue we now take up.

2.2 Revelation-Reason Relationship

The revelation-reason relationship may be looked at in two different ways: (i) reason operating as an *inside* element in discussions on revelation, and (ii) reason confronting revelation from *outside* the faith. The first way of seeing it is Islamic, the second secular. And the meaning of reason changes between the two. The monistic view of Islam includes both sapience and rationality in the ambit of reason. But secularism dichotomizes intellect, rejects sapience, and treats only the rational as reason.[39] For distinction, we shall refer to reason in its Islamic import as 'intellect' leaving the term as it is for secular usage.

Intellect is a faculty that transcends the realm of understanding, and provides prelusive principles for human guidance in worldly affairs. It makes comprehensible to man the metaphysics of the visible and the invisible worlds and of their mutual linkage, thus enabling him to develop a holistic and integrated vision of life. Indeed, there are intellectual foundations to the Islamic conception of God as enshrined in the revelation. For, unlike rationalism, Islam does not see Nature merely as a material physical object for human exploitation and use but accords it a further and deeper significance. The *Qur'®n* upholds Nature — the entire universe — as an open book which man is exhorted to understand and interpret. It is bestowed with a cosmic relevance and must be revered for containing symbolic evidence of God's existence and supremacy: an evidence that intellect alone could grasp and seek to fathom.[40] Thus man can experience and perceive God through His creation.

Intellect invokes *commitment* to faith and ennobles ideas like beauty, love, *iḥs®n*, and sacrifice. It can appreciate — not rationality — why Abraham unhesitatingly plunged into the fire of Nimrod, what made Edward VIII to abdicate the mighty British throne to marry the woman he loved, what fired the legendary Jameela to stand up and face the full fury of the French tyranny during Algerian revolution, or why did Neitzche, the great philosopher, sacrifice his life for attempting to protect a helpless horse from his owner's brutality.[41] Intellect creates ideologies, systems, and revolutions. In Islam, the divine wisdom packed them all into one.

In economics, one may perceive a gain where reason sees a loss. To illustrate, take the first revelation on interest. The *Qur'®n* declares:

> "That which you give as interest to increase the peoples' wealth increases not with God; but that which you give as charity seeking goodwill of God multiplies manifold," (*Qur'®n* 30:39).[42]

Rationality would at once be skeptical of the precept. For, interest payments apparently increase the wealth of the recipients while charity outflows reduce that of the givers. Intuition may, however, convince the committed of the verse's wisdom when, the non-pecuniary gains in terms of spiritual solace and mental tranquillity it must promote are taken into account.

Thus, intellect confirms, not refutes, revelation. However, semantics often tends to become a source of confusion. Tension arises when Islamic scholars unwittingly use intellect and reason interchangeably in their discourses. Consider, for example, the following paraphrased statements: (i) the call for reconciling *wahy* and ^{c}*aql* leads us to the complementarity of revelation and logical positivism, (ii) the truth of revelation was always appreciated in the light of reason, and (iii) Islam provides a telling illustration of unity and harmony between human reason (^{c}*aql*) on the one hand, and the divine and prophetic references on the other.[43] Notice that statements (i) and (iii) use ‘reason’ in its secular meaning while statement (ii) employs it in the sense of intellect. The indiscreet use of the terms apart, there seems to be a lurking desire to depict that reason can always explain revelation. The desire has caused much conflict between orthodoxy and the reform seeking modernism in the literature.

Overdoing the revelation-reason relationship is perilous, and for two reasons. First reason invariably resides under the shadow of error in a dynamic uncertain world. It requires a conscious adoption of the *critical* method for scientific thought as criticism alone can help detect our mistakes.[44] The imperative raises a sensitive question: what portions of the revelation can, if at all, be open to argument, and to what extent? Second, undue emphasis on the relationship is most likely to provide a tunnel for the secular forces to attack Islamic positions from *outside* the system. A dilemma arises for the Islamic scholars because complete seclusion is also neither possible nor desirable. Let us have a brief look at each of the two cases.

Islam exhorts man to use reason for two purposes: (i) to understand the truth underlying revelation and (ii) to interpret its provisions for application in worldly affairs so as to stay on the ‘right path,’ that is, for *ijtih®d*. Of course, the two uses are ordered in a gliding relationship. So the issue of exposure to criticism is much more serious in (i) than in (ii). Over the past two hundred years, the discussion concerning the relationship, as seen in (i), has tended to lurch from one extreme position to another: reason was either largely shunned, or almost nothing was thought explicable save in terms of reason.[45] During the period, both streams of thought have run counter to one another in the

Islamic revivalist movement, though overlaps in individual views have not been uncommon.

Orthodoxy with a ‘limited scope for reason’argument was typically represented in recent times by such eminent personalities as Abul A^{c}l® Mawd,d¬, ºasan al-Bann®, Sayyid Qu•b, and in some measure, al-Attas. The common element in their writings broadly is a scathing criticism of modern philosophy, political orders, economic structures, societal conditions, and the role of science. Paraphrasing Moussalli, philosophically, they reject the claim that man is a possessor of truth or that there is no truth. Politically, they discard the notion that authority belongs to people. Economically, they do not accept that societies are no more than market places where desires of any and every sort are satisfied. More essentially, they advocate Islam which offers a way of life and thought regulated by the divine laws and by nature (*Qur'®n* 30:30); Islam which strives to erect societies whose basic components are justice, virtue, and equality.[46]

They insist that human nature (i.e., *fi•rah* (*Qur'®n* 30:30); instinct or intuition) being the recipient of revelation, is the *true* and *exclusive* repository of moral principles; man cannot arrive at them through reason. Revelation, to them, is axiomatic, requiring no logical proof. Reason, they say, is powerless to comprehend revelation: its proper role is to demonstrate the truth and validity of Islamic *teachings*. In other words, the question primarily is not, as Qu•b puts it, what the *Qur'®n* has said or taught but “*why* the *Qur'®n*, and to a lesser extent, the *ºad¬th* are accepted as the source of politics, laws, philosophy, economics, and, for that matter, all aspects of life.”[47]

In contrast, modernity which sees revelation almost entirely in the range of reason has had among its advocates such illustrious men as Jam®l al-D¬n al-Afgh®n¬, Muḥammad ^{c}Abduh, Am¬r ^{c}Al¬, Muḥammad Iqbal, ^{c}Al¬ Shar¬^{c}at¬, and al-Far,q¬. Their writings differ in many ways but depict a remarkable attitudinal affinity. Rationalism was then sweeping Europe in the wake of scientific revolutions, alluded to earlier. The idea that Islam allowed rational inquiry was being challenged: it was dubbed as a religion of miracles and superstitions.

Islamic modernists rose to provide the required adjustment, and response.[48] They saw philosophy essentially in terms of science. Reason was the main element in the development of science. ᶜAl¬ argues that Islam appeals to reason alone, and that the Prophet of Islam never travelled beyond the confines of reason. He finds Islamic teachings rationalistic and close to European liberal thought.[49] Al-Afgh®n¬ and ᶜAbduh "make science the ultimate judge not only when the *Qur'®n* is obscure or controversial, but also when the *Qur'®n* contradicts science."[50]

The modernists provide allegorical interpretations to those concepts of Islam which they find reason powerless to explain. ᶜAl¬'s description of the life beyond grave and of paradise and hell, as also Shar¬ᶜat¬'s account of *Miᶜr®j* as a symbolic explanation of the Prophet's role in man's ontological ascension from earth to God are the examples. Cases can be multiplied. But in that, they perhaps went too far. Their speculations cannot be verified and at times tend to become heritical.[51]

Common reasoning has scope in expounding revelation, but such scope becomes exhausted beyond a limit (*Qur'®n* 7:3).[52] Reason can, for example, establish the existence of God, but cannot capture His essence. Eschatological concepts, like the Day of Judgment, existence of angels, *jinns*, paradise and hell, or the reality of soul fall outside the range of reason. Some ritualistic practices too seem to lack logical basis. Reason implies that meaningful statements are verified by observation and experiment. Metaphysical statements rarely lend to such verification. In fact, logical positivism uses the verification criterion to exclude metaphysics from scientific discussions.

Indiscreet exposure of revelation to reason may encourage insiders to its rather speculative interpretations, the course which, according to some, *Muᶜtazilah* took in our early history for revamping their discussions to restructure the social order.[53] Of course, they have their supporters even today. And remember, the *Qur'®n* claims to provide guidance to the believers alone (*Qur'®n* 2:2-7). *Outsiders* may only feel freer to attack Islam as did many of the orientalists in the past if we entertain liberal use of reasoning *vis-a-vis* revelation. Illustrative of the Western hostility to Islam, even in academic circles, is the pleasure J.M. Keynes took in needlessly juxtaposing *Qur'®n* with Marx's *Das Kapital* to declare them both as outdated and uninspiring. He exclaimed: "How could either of these books carry fire and sword round half the world? It beats me."[54] The position of the *ummah* today is more vulnerable in almost every sphere of life than probably it ever was, especially in academics. We are in need of closing ranks, not of opening fronts if avoidable. Of course, one need not stand up in support of the tradition-ridden, cultic, divisive, and decadent Islam that pervades most of the Muslim world today. Islam was modern — ahead of time — when it made its advent on the scene; it must strive to regain its position lost over the centuries as the most modern, dynamic and progressive social system today — that is, in the *same* old vein.

Opinions may differ, but to me, it does not seem prudent to invite, much less provoke, outside confrontation at the present juncture. The issue of revelation-reason relationship may be kept somewhat muted for the time being except in matters of application. Application raises the problem of concrete formulations which brings us to another issue: methodology for economics.

2.3 The Question of Methodology

Methodology of economics broadly consists of a set of criteria, rules, and procedures which the philosophers of the subject have evolved over the years to examine the nature, scope, and performance of the discipline. Methodology belongs to the philosophy of economics, and has with the latter the same sort of relationship as has *uṣ,l al-fiqh* with *fiqh*. However, the methodology of economics remains in a rather muddled state. In some measure, the confusion arises because of the failure to keep the issue of methodology separate from that of methods. The observation is all the more valid in the case of writings on Islamic economics.

Methodology is concerned with methods but does not belong to their category. Rather, it is an abstract sort of undertaking which seeks to examine from *outside* the department of economics what methods are the right ones for the economists to use, what the proper way of using them is, and what kind of results are they capable of yielding. For this, it uses principles expressed in the form of certain criteria. Investigators employing the same method — that is, using the same steps in their research and analysis — may hold very different methodological positions, while supporters of the same methodological principles may decide to use very different methods, depending on their judgements concerning various aspects of the problem under investigation.

However, it is important to note that excursions in methodology — that is, the formulation of its principles or rules — is a posterior evolution aiming at formalizing what is right for economists to do after observing what the economists have actually been doing over the centuries. Methodology "provides arguments, perhaps rationalizations, which support various preferences entertained by the scientific community for certain rules of intellectual procedures, including those for forming concepts, building models, formulating hypotheses, and testing theories."[55] It sets up a defense for the scope and method of secular economics, as articulated in current textbook literature.

But what can be regarded as the *right* scope and method of economics depends on the answers to some deeper epistemic questions: "What do we know, and what is the source of our knowledge?" and "How do we know that what we know is correct?" The course an attempt to answer these questions may take depends on the answer to a further question: "Is there an ultimate truth which the scientists are in a process of revealing or is there no truth?" We shall see that methodological differences between mainstream economics and its Islamic counterpart stem from differences in their answers to these basic questions.

The origin of knowledge lies in beliefs, however formed. But to earn the mark of knowledge, a belief has to be certified as true or verisimilar on some criteria commensurate with the goals of science. Methodologies set out such criteria, and are labeled, according to the nature of these criteria as positivist or empiricist, for example. Beliefs, goals, and rules operate as mutual constraints. In secular economics, which shuns divine revelation, hypotheses or theories formulated on some logical (*a priori*) basis partake the nature of beliefs. Predictive success being the agreed goal of the discipline, these theories require empirical confirmation especially following the influential essay of Milton Friedman, *The Methodology of Positive Economics* (reproduced in Hausman). Thus, economics uses the scientific method — a fusion of deduction and induction — in its research and analysis. Logical positivism — the methodology — provides the philosophical foundation to the method.

Logical positivism though seemingly defunct still lingers in the literature for the simple reason that it fortifies the "unity of science" notion and spurs economic theory to continue providing a rationalization for the liberal democratic ideology of capitalism without normative commitments. A critical review of logical positivism does appear in the methodological contributions of Karl Popper, Thomas Kuhn, and Imre Lakatos and others, but the development their writings ushered in does not signify so much a departure from logical positivism as an attempt at its refinement, and a recognition of the limitations of empirical testing. They maintained the "unity of science" view, endorsed the predictive goal of economic theories, and did not give up the demand for their empirical testing. They remained *within* the ambit of positivism, though they modified and enlarged it in some ways.

A real departure from logical positivism is found in Paul Feyerabend's anarchistic theory of knowledge. To him, the best approach to scientific investigation is freedom from commitment to any method, for, commitment to method limits creativity in problem solving. For him "anything goes." Though the argument may itself look anarchic, it opened the doors of the rhetorical and sociological approaches on economic theorizing. Recent developments in the area of methodology under their impact further pinpoints the illogic of logical positivism, more so of its "unity of science" gospel. There are basic differences, it is argued, between social and natural sciences, including economics. An economic theory known to the participants in economic activities affects the working of the economy itself. Such interaction between the theory and the object of the theory is certainly absent in natural sciences. The fact makes the formulation of theory in social sciences very difficult and restricts its application over time and space.[56] Social sciences, like economics, should presumably aim more at enhancing our understanding of the phenomena they deal with than pursuing the predictive goals. In social sciences one wants to know the details of specific happenings to appreciate their distinctiveness than to see them as mere instances of general uniformities. Uniformities in human behaviour do not depict operation of some natural laws, they result from rules and institutions shaped by cultural and religious forces. To understand these rules and institutions is a task requiring interpretation, not theorizing and empirical testing. Predictive power need not be the hallmark of a social theory. In fact, in the case of economics it is found that its theories remain weak for prediction. Ironically, much of the empirical work in economics does not attempt to refute testable predictions, but seeks to confirm them for reasons of relative ease. History has evidence of the discipline's indifference to predictive improvement in contrast to its desire for formal tractability.[57]

Though inspired by these meaningful developments, the *rhetorical* and *sociological* approaches could not, be free, like others, from the serious intellectual disorder that originated in the programme of Descartes to built knowledge on the foundation of radical doubt, and of which positivism had only been a symptom. This disorder continues to afflict both mainstream economics and its philosophy, and now seems to juxtapose them in a state of perpetual conflict and confusion because of the absence of a moral or ethical base.

Nevertheless, the new approaches are distinct from their forerunners in a way which may be of some interest to the process of Islamizing economics. They exhibit an unmistakable skepticism about one's ability to discover the ultimate inviolable truth. A theory does not necessarily evolve, it is argued, because it is the closest to truth but because of a variety of other reasons: persuasiveness, institutional constraints, and cultural norms may all influence the acceptability of a theory. The demands and interests of public policy makers or private employers do influence the questions economists ask and the solutions they choose to present for consideration. The claim of mainstream economics to neutrality towards the ends is naive; it basically is a normative science policy traveling in a positive disguise.[58] The departure from the "unity of science" theory, and inclusion of the normative and social considerations in methodological frames brings mainstream literature a step closer to Islamic demands, and may over time lead towards a narrowing of the gap between the two.

However, under Islamic dispensation, economics, like other disciplines, may still differ much from its mainstream counterpart on numerous matters including the question of methodology. Islamic economics does not rise from the shadows of doubt and presumption on the wings of human reason to take any direction the pilot chooses; it springs from the fountainhead of revelation — the epitome of truth for the believers — and remains anchored to it. Here, methodology does not seek to formalize what economists actually do. Instead, it sets the goals for Islamic economics, prescribes behavioural norms for their achievement, and formulates rules for evaluating the results. The glide from economics to methodology, as it obtains in secular order, is reversed in an Islamic arrangement. The reversal gives a purpose, unison, and direction to Islamic economics and makes the discussion of methodological issues all the more important in its case.

We may begin with the statement that every society has a method it agrees upon for organizing production and distribution of wealth. The method embodies a doctrine concerning economic activities. The doctrine signifies the course society prefers for solving its practical problems. It is based on some moral or scientific concept which impart to it a sort of intellectual balance. No economic doctrine is meaningful without a method or conceptual base. For instance, to understand the advocacy of capitalism for economic freedom, one must examine the fundamental ideas — self-interest, competition, extremum solutions, etc. — it relies on as also its *modus operandi* — the market. This is true of all doctrines in secular economics. From its very inception, the discipline has traversed through a maze of economic thought.[59]

On this criterion, the term Islamic economics is clearly a misnomer. It relatively is a new subject, while Islam is a missionary religion, a way of life; its real job is not the pursuit of scientific investigation. We talk of Islamic economics more in a manner of speaking perhaps because no better expression is available. It is described as a science in the sense of "systematized knowledge," the stature it is fast acquiring.

In order to formalize matters, we may define Islamic economics as that aspect of Islam's social doctrine which deals with problems of choice in the face of uncertainty and resource scarcity so as to promote *fal®ḥ* in a holistic framework. Islamic economics is a science as well as an art. As a science, it has both positive and normative aspects. The positive aspect provides us with an understanding of "how it works" of the economy. The normative aspect is ideological and prescribes for the economy the goals to achieve. The art of Islamic economics links the positive with the normative aspect of the science, and seeks to answer the sort of questions such as: Given the normative goals and the way the economy works, how can the goals be best achieved? Anas Zarqa quotes from the *Qur'®n* and the *Sunnah* some apt examples of positive, normative and mixed statements which support our position.[60] And, if the discipline is to make progress, we have to strengthen its scientific outlook, subject to the norms of the *Shar¬cah*, for enabling it to explain, interpret, and modify economic phenomena as they develop and unfold in the expanding Muslim economies.

One inspiration for having such an outlook comes from the anomaly that afflicts the Western "unity of science" theorem. The Western philosophers of science agree in general that the physical world is governed by natural (read divine) laws. Natural sciences strive to discover these laws which are taken as expressions of *truth*. Innocuously, in the social arena also they use the same scientific method to reach the truth through establishing behavioural uniformities. We have already noted that the effort was misdirected and the pursuit of ultimate truth in social sciences, including mainstream economics, stands abandoned. The failure stems from the partial and distorted worldview the West chooses to hail as 'scientific.'

In contrast, Islam takes the entire universe, including man and nature, as one *unit* whose components are *all* subject to the same general law which is ordained by its Creator. Nature is *destined* to submit to this law and no disruption or disturbance can touch it without God's will (*Qur'®n* 7:54). But, unlike nature, man is not obliged to obey the universal law. Instead, God prescribed for him the *Shar¬ᶜah* and granted him *discretion* in its observance. The West used this discretion to belittle faith and rely on human reason alone in social sphere too, only to land in confusion. Human beings and their social interactions are clearly different objects of study than are planets and proteins; the two cannot be subjected to the same method of inquiry, and analysis. On the other hand, the *Shar¬ᶜah* is a part of the same general law of God which governs the whole universe including the physical and biological aspects of man. We believe that if man follows the law, his life remains in harmony with his own nature, and with the rest of the universe. If he does not, he is seldom at peace with himself, and may spread corruption on earth. Truth is indivisible in Islam: it is the law we are talking about and everything in existence either follows it or is punished by it (*Qur'®n* 2:38-39; 21:10-20). The "unity of science" theorem is then consistent and cogent *within* the confines of the *Shar¬ᶜah* which alone contains the absolute inviolable truth man could ever know (*Qur'®n* 10:108; 69:51). If the truth had been in accord with human desire, the heaven and the earth and all things therein would have been in confusion, and corruption (*Qur'®n* 23:71). The *Qur'®n* uses both intuitive logic and empirical evidence to convince man of the truth its verses express. In fact, the scientific method which is the dynamic spirit of modern Europe's industrial culture is a distorted borrowing from Islam: it originated in the universities of Muslim Spain and the East.[61] 'Distorted,' because the Islamic method never imposed self-interest as an exclusive limitation on rationality. It does recognize the link between them, but commitment to faith (*Qur'®n* 30:30) overrules reason, if they conflict.

The goals of Islamic economics can be quite flexible to meet temporal requirements without violating the prescribed norms. Scarcity of resources does not arise because of nature's niggardliness, as L. Robbins laments[62] or because of their wasteful use and inequitable distribution as some Muslim economists maintain:[63] the latter are merely the aggravating factors. God is benevolent and has stocked the earth and heavens with His inexhaustible treasures for His creatures (*Qur'®n* 15:20; 41:10). Scarcity of resources primarily is the consequence of man's insufficient knowledge of their existence and use. Knowledge flows to man from God, its primordial source. He releases it to man only bit by bit so that man may not become arrogant. Islamic economics guides people towards achieving *fal®ḥ*. The concept keeps in the forefront the significance of using life in this world as a *means* to having peace in the hereafter, the ultimate aim of human existence (*Qur'®n* 28:77). In fact, the notion of *fal®ḥ* is an epitome of the *Shar¬cah* objectives.[64] Justice or *al-cadl* is the guiding star of Islam's societal organization (*Qur'®n* 16:90). In principle, it prefers better distribution of wealth and income to their larger production. The 'normative' compulsions in the discipline generally overshadow the 'positive' ones if there has to be a trade-off. And it is just in this choice that Islamic economics acquires its practical significance, also distinction.

Normative compulsions need not shut out Islamic economics to the use of scientific procedures for research and analysis. Even the mainstream economic structures erected right from Adam Smith to more recent times have rarely been free of ideological underpinnings.[65] Still, the limitations of Islamic economics in the matter are more serious; for unlike mainstream economics, it seeks to make the reality of economic life adjust to a prefixed ideology or an ideal of justice. The essence of this ideal broadly is: help the needy, reward the deserving. This ideology or ideal is handed down to Islamic economics by revelation.

The ideal of justice is not scientific, as justice cannot always be easily observed or measured. But when the ideal touches human ideas or scientific formulations, it mostly changes their character, at times radically. To illustrate, it happens when an *am®nah* or trusteeship dimension is added to property rights, or the rate of interest is reduced to zero. The ideal does not usually intrude in such of the matters that fall in the domain of science. Examples of the sort are the laws describing input-output relations, and price formation by market forces. These are objective scientific facts deduced from reality. However, the product-mix and its distribution, or the behaviour of the market as economic arbiter must meet the prescribed norms to avoid social intervention. Islamic norms of justice are principles of social (economic) policy. They are summed up in the Islamic view of *ḥal®l* (permissible) and *ḥar®m* (non-permissible). If some Islamic text prohibits an act, directly or indirectly, the act is *ḥaram*, if not, it is *ḥal®l* (*Qur'®n* 7:157; 16:116).

Thus, one task of methodology of Islamic economics is to indicate what is *ḥal®l* or *ḥar®m* for the discipline, and in that specify its ethical norms and values. This brings into the picture the intricacies of juridical procedures and principles, which this paper is not the appropriate place to deal with. However, some observations may be helpful. Economic doctrines and the systems they erect have in all cases been intimately related with civil law. Though the two are never identical, the study of a country's legal provisions may acquaint one with the key elements of its economic system and the reverse may also be true in some measure. However, their nature and interrelations are much different in the Islamic social order when compared to those in other dispensations. In contrast to position elsewhere, ethical doctrine in Islam is closely connected with law. *Fiqh* makes no special distinction between rules concerning conduct and those which other systems consider as belonging to the realm of civil law.[66] For this reason, in Islam, jurisprudence is the edifice on which its economic structure is raised while in other cases the relationship is reversed; primarily the civil law must adapt to changes in the economic doctrine.

Methodological goals in the case of Islamic economics are not the same as elsewhere. Here, one is confronted with an economic doctrine already in existence. The task is to bring out the reality underlying it, to make firmer the contours of its framework, to lay bare its basic rules of thought, and to get rid of the impurities that invaded it over time, especially during colonial dominance of the Muslim lands. Thus, it is the *rediscovering* of what the dust of time and circumstances has largely blurred beyond recognition; the task is not to *create* or modify doctrines and systems on the basis of pure reason as it is, for example, the case in capitalism or socialism.

To embark on such a discovery is not an easy undertaking. The Islamic text does not provide us with a vivid picture of the economic doctrine it means to put into operation, not even any of its major aspects is made clear. To give just one example, it does not explicitly indicate as to whether the doctrine holds the principle of common property or of private property, and if it does allow private property, what its theoretical basis is: want, need, work or freedom?[67] The difficulty requires the search for another method to discover the doctrine, and illuminate its shady spots. The method is to adopt a juridical approach. When the text is unclear on a point, the law relies on some textual conception explained by tradition (*ºad¬th*) analogy (*qiy®s*), consensus (*ijm®c*) or relevant historical evidence. The Islamic position on land ownership is, for example, clarified in a tradition: "The land belongs to Allah, the Supreme. He has handed it over to men to be held in trust. So, it should be taken away from a person who leaves it idle and uncultivated for three consecutive years without reason, and be given to some one else."[68] Here it is the law that explains the doctrinal position.

However, textual conceptions may not always be available to fill the gap in the economic legislation. In such a situation, Islam empowers the state to make the necessary provision. For example, Islam sees exchange as a part of production. The state can, therefore, take steps to eliminate the middlemen operating between the consumers and the producer through a procurement and distribution policy, or by encouraging the cooperative movement, if social interest so demands.

Finally, in the present day complex and dynamic situation, Islamic economics has to be forward looking, expedient, and pragmatic. The door of *ijtih®d* must remain open. The principle of *facility* assumes special importance. But it does not mean freedom to bend religion —

as sometimes Muslim economists and politicians tend to do — for justifying the existing realities, or for isolating a *Shar¬cah* provision from its context to support or reject a viewpoint.[69] The temptation must be resisted.

3. Outline of Agenda

One implication of the foregoing discussion is that the issues concerning Islamization of knowledge in economics or other social sciences are not always taken note of by those venturing into the field. Partly, the reason is that education policies in Muslim societies still are in a large measure under the sway of their colonial past. Their institutional structures, course designs, reading materials, teaching programmes, and performance appraisal procedures all continue to carry deep Western imprints. By training, their scholars often are less receptive to Islamic ideas. The recent trend of extending privatization to the area of education may increase or decrease their estrangement, depending on its ultimate impact on the Western influence. There are presently many imponderables in the situation. But one thing is clear: there is going to be an increase in the flow of instruction from the market to the academy as modification of the present position. Its consequence for Islamization of knowledge has to be watched with great caution.[70]

The point is that not everything in the Western academic tradition is unwelcome; it offers much worth emulating with advantage. But if the objective is Islamization of knowledge, *much* is not conducive either. Be that as it may, the situation is in no way alarming: it may only make the task more difficult and challenging. The process of Islamization faces three basic problems at the implementation level: preparing the reading materials, restructuring of the curricula, and promotion of academic leadership. The three are interrelated and have to be dealt with simultaneously.

3.1 Reading Material

Among social sciences, the pace of Islamic economics has been faster in emerging as an independent academic discipline. The subject is now being taught at some secular institutions in the West with Islamic economics being a recognized area for accepting students in their Ph.D programmes. Interestingly, the school facilities seem to expand at a faster rate than the availability of suitable and adequate reading materials for the students studying the subject at various levels. The shortage of textbooks is, in particular, acute.

At present, for Islamic economics courses, the students have to rely on articles, monographs, and books which do not always serve the purpose for a variety of reasons. For example, some of the works presented for use as textbooks do not fill the bill because the material they put together was not originally meant to serve the students: they are largely collections, expansions, or translations of authors' writings contributed to journals or conferences or done earlier in vernacular. Again, much of the material available is in immediate need of revision, improvement, and updating. Some of the materials used at the university level is not entirely free of formulation errors and faulty equations or diagrams. Also, edited works from a limited literature base tend to proliferate. They *are* needed but the need for original contributions obviously is far greater. The editing norms are not always observed. At times, the editors neither contribute an introduction commenting on the material selected, nor care to put it in a cohesive arrangement. These observations are not meant to detract in any way the value of numerous learned contributions to Islamization of knowledge made by individual scholars and institutions.[71] However, they seldom cover more than the fringe requirements of an academic programme. The question is: where do we go from here?

The question is not easy to answer; it seemingly puts one on the horns of dilemma. A writing in the area of economics, for example, may not be considered fully Islamic unless, taking cognizance of the argument of the preceding section, it insists on gearing action in this world to the requirements of solace in the hereafter, allows reason to operate only within the confines of faith, and demands adjustment of reality to the dictates of (Islamic) law and not *vice versa*. But such writings will be akin to those as produced on the subject by the jurists in the past, and would require such a revolutionary restructuring of the economy as any political authority would rarely venture to initiate in today's circumstances.[72] The present position of Muslim countries in the matter of their cultural values, thought processes, institutional structures, administrative arrangements, and economic positions is a departure from Islamic norms through history as they have remained for centuries under the spell of non-Islamic influences. Pure Islamic models, with an all-or-nothing approach, must, therefore, look unrealistic. They would rarely inspire the reader, or elate the policy-maker. Overnight transformation of history-determined phenomena in a peaceful orderly way is hardly possible. The economies of Muslim countries cannot be jerked off the global web without inflicting serious abrasions. What, then, looks desirable for Islamizing economics is to shape the discipline such that it seeks absorbable, even if partial, step-by-step departures from the mainstream bearings, the establishment of an independent identity being the eventual goal. Thus, the 'comprehensive' approach is not feasible, while the 'partial' one is uncertain and time consuming.

However, there is another way of looking at things. The two approaches to the Islamization of knowledge, in economics or other fields can be pursued simultaneously as they complement each other. Pure Islamic models, as stated in the beginning, may help indicate the direction for movement towards the ultimate goal, put in focus the behavioural norms, create the desired mental attitudes, make clear the system's key variables, and unfold their interrelations. These are invaluable contributions for designing partial models and shape policy prescriptions. Partial models, in their turn, are more flexible and facilitate the Muslim thinking to adjust to the imperatives of the contemporary world, and to deal with the challenges the *ummah* is currently facing. When put into operation, they may yield valuable insights to modify the pure models *vis-a-vis* the changing realities of social dynamics in an Islamic framework.

If a step-by-step partial model approach to Islamizing knowledge is considered expedient, the textbooks planned for economics must have an appropriate blend of the Islamic and mainstream positions in a "compare and contrast" mould, where possible and relevant. In addition, a textbook must adequately cover the essential aspects of the subject it deals with. The material provided should commensurate with the level and duration of the course. Simple language and a lucid style are obvious advantages. The use of mathematics should not be overdone.[73] The work must exhibit awareness of recent developments in the literature on the subject, more so in the applied areas. Last but not the least, provision of appropriate questions and exercises at the chapter end may greatly help recapitulation and appraisal.

Islam presents an action programme. But contemporary Islamic writings look 'theoretical' because Muslim societies mostly operate along secular lines. For this reason they often show traces of drift and qualitative unevenness. Since students take recommended readings as devoid of errors, it is advisable to have a system of expert clearance before materials are included in the list. Also, the vernacular should in principle be the medium of instruction at all levels, with only unavoidable exceptions. Teaching through a foreign language seriously tells on the students' interest and capacity for learning. Thus, until after the beginning of the present century almost every university in Europe maintained a strong translation department to transfer into Latin the treasures of knowledge from Arabic and other Eastern sources. Russia, Japan, and China are some of the later examples to use the method for acquiring the Western scientific and technical knowledge. It is well to note that the International Islamic University of Malaysia (IIUM) has made a modest beginning in the direction: it has established a translation unit in its Research Centre.

3.2 Curricula Development

In general, the universities in the Muslim world are maintaining the same curricula structures as the countries inherited from their colonial past. Adjustments in response to local demands have been marginal, though not rare. Real modifications follow mainly the changes in the West, to stay 'international.' Islamic instructions, where part of the university programme, are a secluded matter, and have little impact on the mainstream curricula. The dilemma of the Islamization of knowledge is how to shun this dualistic character of education in Muslim societies? The difficulty is a close and growing linkage between the mainstream course designs and the job market where requirements are being increasingly determined by the Western business culture and life styles for obvious reasons.

The situation makes the partial step-by-step approach to the Islamization of knowledge even more appropriate: it would smoothen the process of removing curricula dualism from the Muslim institutions of higher learning. All the same, the task requires courage, sacrifice, and sagacity of no mean order. It may be noted that several institutions engaged in teaching, research, and training, including the IIUM, are making earnest efforts in that direction, and that these efforts are beginning to bear fruits.

The approach for ending the dualism has three broad features. First, there are some foundation courses in Islamic revealed knowledge compulsory for all undergraduate students. To the list may probably be added a course in Islamic history to give students a feel of their glorious past for promoting self-esteem. This has already been done at the IIUM, albeit presently on a selective basis. Arabic is vital for Islamizing knowledge. Even so, it should be obligatory only on a selective basis.[74] Second, the individual subjects have a category of courses primarily Islamic in content but with a blend of mainstream positions. Lastly, there are courses from the Western mainstream where effort is made to present things in an Islamic perspective, if possible. The idea is to infuse progressively more of Islamic content and perceptions in the latter categories. And it is here that the pace is painfully slow, and requires regular effort and monitoring. The crux of the matter is how to have the overall course structure in such a way as would keep the students competitive in the job market vis-a-vis those coming from the secular education stream? One requirement clearly is that the students in the Islamic institutions must be willing to sacrifice leisure in some measure to learn more for achieving the parity.

This would depend, among other things, on the quality of academic leadership all along the line, popular support and political action. Required at the top is a scholar of eminence — firm, tactful, tolerant, and committed. Down the rungs, administrative hierarchy — deputy rectors, faculty deans, department heads, etc. — must, in principle, follow the academic standings with departures only when unavoidable. In any case, the men in these positions must be competent and devoted to the mission. Simultaneously, if political leadership can put Islamic models into operation, especially in the field of economics and management, market demand for Islamic stream students may emerge and expand to their elation. This is what is being done in Malaysia today in such important areas as banking, capital markets, insurance, and investment, and the process is gathering momentum. The linkage, thus, being forged between Islamization at the IIUM on the one hand, and the job market on the other promises to make the country a roll model for the Muslim world, and beyond, in the field of Islamization of knowledge and its successful application.

4. Concluding Remarks

We started the present discussion with the sharing of a common perception that Islamization of human knowledge is the key for restoring the prestige and prosperity the Muslims enjoyed at the global level not too far back in history, and that the work has yet to pick up the right course or pace, even in economics — a relatively more developed discipline. Broadly, two interrelated factors seem to impede the progress in the area: (i) the lack of a clear understanding of the relevant issues, on the part of many, at the theoretical level, in a comparative setting, and (ii) the inability of leadership — academic and political — to evolve a satisfactory trade-off between the Islamization imperatives and the secular job market compulsions during the transitory period.

The approach to Islamization of knowledge in a discipline can be comprehensive or partial. The first takes an all-or-nothing view of the matter and insists on radical changes in the social structures. It has little operational value in today's circumstances but keeps the ultimate objectives in focus, and helps construct instructive 'pure' Islamic models. The partial or step-by-step approach is a transitory expedient and gets its inspiration from the comprehensive model. However, in either case one is to have a clear grasp of the main and intertwined theoretical issues — the worldview, reason-revelation relationship, and methodological constraints in an Islamic dispensation vis-a-vis their secular counterparts for useful writings.

Implementation of the programme requires a gradual approach inspired by the ultimate goal, an inspiring leadership, competent academia, and unflinching political support. More reading materials, especially textbooks, evaluated for quality have to be produced for students' use. Despite shortcomings, the present state of Islamization of knowledge in economics, is not so dismal as some may want us to believe.[75] But then, it is a matter of taste — of seeing the glass half-filled or half-empty.

Endnotes

1. The latest restatement of his ideas is contained in Ab,Sulaym®n (ed. 1995). Its Introduction and Appendices provide a useful thumbnail history of the evolution of Islamization theme as part of the wider Islamic reformist movement.
2. Although the importance of Islamizing knowledge is emphasized in almost every writing on the subject, Ab,Sulaym®n (1985 and 1993) projects it in a way that makes the idea almost his own.
3. Writings on Islamization of knowledge invariably assume a general overtone. Subject specific deliberations are not many, penetrating ones even

fewer. The present paper seeks to fill this gap in the case of economics, which is also the author's area of professional interest.

4. The demarcation between economic and non-economic welfare, objectivity and value judgements, ends and means, positive and normative statements, and many other social positions is really difficult and confusing. Pierre Duhem raised the issue in the area of methodology. See Redman (1991, 38-9, 128).

5. See, for example, Roy (1989, 1-4) and Hausman (1984, 1-2).

6. Roy (1989, 17-32) summarises the views of leading economists to show the agreement that arguable values have 'normative' status, those beyond reason are mere 'opinions.'

7. For example, in Lipsey's *An Introduction to Positive Economics* (1963, 4) we find, "Positive statements concern what *is*, *and* normative statements concern *what ought to be*." This distinction, of course, has since long come under fire (Redman 1991, 95, 100 n. 16; Hausman 1984, 15).

8. See Qu•b (1978, Chap. 2), "The Nature of Qur'®nic Method."

9. Even Ism®c¬l al-Far,q¬ emphasized this point: "How long are we going to content ourselves with the crumbs that the West is throwing at us? It is about time that we make *our own original* contribution. As social scientists we have to look back at our training and reshape it in the light of the *Qur'®n* and *Sunnah*. This is how our forefathers made their own original contributions to the study of law, history and culture. The West borrowed their heritage and put it in a secular mould. Is it asking for too much that we take this knowledge and Islamize it?" Quoted in Ilyas (1988, 16). Emphasis added.

10. Rosenberg (1992, 39).

11. In this category one may like to include Ab,Sulaym®n (1985), Dhaouadi (1993), Safi (1993), Ibrahim (1990), and Moussalli (1990).

12. For a vivid explanation of the point, see Shar¬cat¬ (1982, 22-5).

13. *ibid.*, 25-32. Examples are provided to clinch the point. –

14. This has been one of the central themes in Muḥammad Iqbal's poetry. See for example, Shar¬cat¬ (1982, 18 no.2).

15. *ibid.*, 10-3.

16. *The Holy Qur'®n* (31:20; n.3605; 67:15).

17. Al-Attas (1995, 1).

18. For their integrated explanation and implications, see Siddiqi (1989). Good explanations are also available in Shar¬cat¬ (1982) and Qu•b (1978).

19. For example, it seems to us that Al-Attas's attitude to change in the

Islamic worldview as a consequence of social dynamism is too restrictive, while that of Shar¬cat¬ is too liberal.

20. For explanation of the 'hard core' concept in MSRP see Redman (1991, 36).
21. See —adr (1983, 7-9), Al-Attas (1995, 5), and Qu•b (1978, 57).
22. Islamic jurists' writing on economic matters, including —adr, do not make a distinction between economy or economic system and economics, and invariably use the terms interchangeably.
23. See in Hasan (1988), the section on Amanah.
24. It is so in secular social orders also, but in Islam the two are integral parts of a whole. See Qu•b (1978, Chap. 9) for an implicit argument.
25. For an elaboration of the concept in an economic context, see Hasan (1988, Supra n.23).
26. Redman (1991, 176 n.11). See also Gide and Rist (1953, 516-70) on the economic role and impact of Christianity through history.
27. Redman (1989, 9).
28. Oser and Blanchfield (1975, 496).
29. See relevant passages quoted in Chapter II Section II of Gide and Rist (1953, 87-8, 103 n.1). See also Roy (1989, 29).
30. *ibid*.
31. Oser and Blanchfield (1975, 497).
32. The view originated in Physiocracy, "The natural order, so the Physiocrats maintained, is the order which God has ordained for the happiness of mankind," Gide and Rist (1953, 28). Later on the secularists detached nature from God, treating Physiocracy as the bridge to make economics cross from the moral end to the 'natural' end of human thought. Naturalism in this form survives, rather dominates, in mainstream economics even today.
33. Redman (1991, 104).
34. It is now widely accepted that often an 'is' implies an 'ought,' and the line of distinction between the two is largely a matter of opinion. See, for example, the discussion in Roy (1989, 47-9).
35. Shar¬cat¬ (1982, 28).
36. For a brief statement of these achievements, see Hasan (1995, 57-8).
37. Shar¬cat¬ (1982, 50).
38. *ibid*., 56-67.
39. Hasan (1995, 59); also, al-Attas (1993, 18, 35).
40. al-Attas (1993, 35).

41. Shar¬cat¬ (1982, 97-8), provides the full narration of the incidence.

42. See also (*Qur'®n* 2:276) on this point.

43. The paraphrasing is from (i) Arif (1987, 54), (ii) Safi (1993, 35) where he refers to Moten and (iii) Dhaouadi (1993, 155). Notice also Safi's comment on the first two.

44. Popper always emphasised the value of criticism for improving economic theories. He wrote: "This hint, very simply is that *we must search for our mistakes* - or, in other words, that *we must try to criticise our theories*. Criticism, it seems, is the only way we have of detecting our mistakes, and of learning from them in a systematic way," quoted in Redman (1991, 133).

45. Moussalli (1990, 317). He provides a balanced account of the two opposite streams of thought and also brings out the overlap between individual writer's views across the lines.

46. *ibid*., 315.

47. *ibid*., 318.

48. *ibid*.

49. Ahsan (1985, 193). He compares Comte and Am¬r cAl¬ on the point. The whole article is interesting and illuminating.

50. Moussalli (1990, 316).

51. For Shar¬cat¬'s account of *Micr®j* see Yadegari (1985, 58). An American convert, Maryam Jamilah, for example, observes about Am¬r cAl¬'s work: "If the *culam®'* had been alive to their duty instead of sleeping, the contents of this book (The spirit of Islam) should have been denounced as heritical," quoted here from Ahsan (1985, 205).

52. Two of the supportive verses may be mentioned: "if you have difference of opinion concerning something, refer to God and His Messenger," (*Qur'®n* 4:59). And, "Whatever the Messenger gives you, accept it; whatever he forbids you, refrain from it," (*Qur'®n* 59:7).

53. "Maintaining as they did that Islamic thought could be based essentially on the *Qur'®n* and the *Sunnah*, the orthodox *culam®'* did not consider rationalism a legitimate approach for finding the ideal social order. Yet, in the early years of Islam, there had been a significant number of thinkers who upheld it. Among them were the Muctazilah, whose popularity and strength peaked in the eighth century. While not denying the validity of the *Qur'®n* and *Sunnah*, the Muctazilah tried to accord reason a systematic role in discussions about the social order. Considered a threat to Islam, they were persecuted and their writings destroyed. What little we know about their

specific views is based on summaries provided by their critics," (Timur Kuran in Lowry, 1987, 108).

"(Am¬r) cAl¬ criticizes the Abassid Caliph Mutawwakil and for his suppression of Muctazil¬ thought, as well as Aḥmad bin ºanbal for his, as cAl¬ puts it, anti-rational attitude. He believes that it is because of this kind of attitude that Muslims of the modern age have fallen far behind their European contemporaries," Ahsan (1985, 189-90).

The controversy led to what Ab‚Sulaym®n (1985, 270) calls the "split of leadership" detrimental to the progress of the *ummah*. He aptly observes: " . . . the crisis (in the Muslim mind) lies in the perception of the relationship between revelation and reason," and calls for its rectification. But how this can be brought about is *the* question.

54. Ghosh and Ghosh (ed. 1991). The authors reproduce interesting correspondence on the point between J.M. Keynes and J.B. Shaw. Shaw wrote back "Lord help you, you know nothing. . . Mahomet was an epoch maker, and there is much excellent doctrine in the *Koran*. Marx with his manifesto and his *Capital* also made an epoch . . . And you Maynard . . . are . . . a bright and promising youth . . . frightfully handicapped by the Cambridge nullification process . . . Hence, my writing . . . to save you from one or two blunders as to things which happened before your time," (Ghosh and Ghosh, 1991, 54).

55. Redman (1991, 96) quotes from Fritz Machlup's classic discussion: "What is meant by Methodology, selective Survey of the Literature," (Redman, 1991, 54-5).

56. Hausman (1984, 27). Also, Rosenberg (1992, 11-7).

57. Predictions are considered self-defeating. See Redman (1991, 107, 134 n. 3).

58. Mark Blaugh in Hausman (1984, 375).

59. Landreth and Colander (1994, 7-8) put in a brief sketch of the main developments through history.

60. Zarqa (1989, 23-8).

61. Qu•b (1978, 208-9).

62. Robbins, L, *Nature and Significance of Economic Science*, in Hausman (1984, 116).

63. For example, Khan subscribes to this notion of scarcity of resources (Khan, 1994, 45).

64. The word *fal®ḥ* occurs many times congenerically in the *Qur'®n* and refers to what it regards •*ayy®b* for human beings. A good exposition of the

concept is found in Khan (1993, 33-44).

65. Schumpeter, “Science and Ideology,” in Hausman (1984, 267-71) gives an interesting account of the visions of three great economists — Adam Smith, Karl Marx, and J.M. Keynes.

66. Levy (1957, 204, 255, 256). Also, —adr (1983, 15).

67. The private ownership of property in capitalism is institutional while in Islam it is derived from the concept of *am®nah*. The implications of the concept in the two disciplines are, therefore, different with reference to such questions. See discussion in —adr (1983, 17-8, 31-2).

68. Quoted in —adr (1983, 33).

69. *ibid.*, 39-53. Interestingly, while —adr wants to see the ‘reality’ adjust to the Islamic ‘norms’ (Chap. 1), Naqvi advocates for a movement “from the ideal to the reality!” (Chap. 12). Each viewpoint has its supporters. Only time will decide the trade-off between them.

70. Privatization of education provides a chance for Islamic movements to establish more institutions of their choice and can facilitate Islamization of market structures. On the other hand, globalization of trade, and import of foreign educational materials, and systems would work in the opposite direction. The result is, at present, any body’s guess.

71. However, the recent tendency of many writers, even of some at the top, to churn almost the same material in various combinations, with not much new addition, does increase the number of publications but hardly adds to the pace of Islamization of knowledge.

72. Even on the mainstream front, take for example, the disenchantment from the once elating occupation with the basic needs fulfilment as one of the top development priorities for the simple reason of the politicians developing cold feet to give the economy the “shake up” it needed for the purpose.

73. Even in mainstream economics, the use of increased mathematics is now being seen more as a matter of professional politics than need. Notice the title of Rosenberg’s book. Also, see Roy (1989, Chap. 9) and Mark Blaugh in Hausman (1984, Chap. 21). Islamic economics essentially deals with values and perceptions which are difficult to quantify.

74. For example, in certain professional courses where the bulk of the students do not go for graduation or research, burdening them with learning an extra foreign language may not have commensurate utility. To that extent, it may represent a waste of valuable time and resources.

75. An interesting example is Naṣr’s work. His tone is acrimonious and

conclusions overdrawn, though his anguish is understandable. Few will dispute his remark on Islamization of knowledge: "It has claimed much, but delivered little," (Naṣr, 1992, 1). However, his observations often lack clarity or supportive documentation.

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ISLAMIC PROJECT FINANCE AND PRIVATE FUNDING SCHEMES

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Abstract

As governments find it increasingly difficult to finance major projects, private sector companies are becoming involved in electricity generation, telecommunications expansion and infrastructure provision including toll roads, ports and airports. From an Islamic perspective there is no objection to such private provision, indeed the participatory nature of the involvement is welcome, but there are *Shar¬ᶜah* compliance issues. Recourse to borrowing on the basis of *rib®* is *ḥar®m* and Third World debt crisis of the 1980s illustrated the perils of such an approach, as has the more recent Asian financial crisis. The adoption of Islamic financing techniques such as *istisn®'* can avoid such difficulties. Proper project evaluation is needed for such financing to be successful, and decision makers require good information. Discounting of future income is seen as legitimate by Islamic economists, as such techniques can be used for the calculation of social rates of return in Muslim societies.

1. Introduction

Knowledge reduces the uncertainty involved in any project which will take time to reach fruition. The trade-off between increased knowledge and reduced uncertainty is widely recognized in the standard literature on finance, but much less has been published on this trade-off from a specifically Islamic perspective. There have, however, been a number of contributions from Islamic economists which are potentially relevant to this issue. The aim here is to explore whether modern techniques of project appraisal can be used by Islamic financial institutions and if commercial funding methods are appropriate given the needs and circumstances of Muslim countries and communities.

With diminishing state funding of projects and increasing private sector involvement, good information flows are essential if projects are to be properly evaluated and regulated.[1] The consequences of the change from state to private funding is reviewed in this paper, and the implications for Muslim countries explored. The issue of discounting is considered, as this potentially causes problems from the perspective of the *Shar¬cah* (Islamic law) if the discount rate is equated with an interest rate which constitutes *rib*®. Discounting, however, is a useful tool if decisions on the merits of different projects are to be made on the basis of a comparison of their present values. Such calculations enhance the knowledge of decision makers, by enabling them to compare like with like, on the same terms.

The paper also examines how projects can be financed when interest-based debt finance is ruled out. There are, of course, a number of Islamic financing methods which have been well tried and tested, but often it is not simply a matter of replacing debt finance with one particular Islamic mode of finance, but rather of determining what the optimum combination of Islamic financing techniques should be for a particular project. The aim is not only to replace interest-based debt finance with an Islamic financing instrument that performs a similar function, but rather to ensure that the financial arrangements are both just and efficient. It is not merely the letter of Islamic law which matters, but also its spirit.

2. State Arrangement of Project Financing

In the 1960s and 1970s in most developing countries, governments provided the funding for infrastructure projects such as roads, ports and airports, hospitals and school buildings. Ministries of Transport, Health and Education were directly involved in the design and execution of projects. Utilities such as gas, electricity and telephones were part of the public sector, and here again Ministries of Energy and Telecommunications were usually responsible for commissioning and supervising projects, even where the utilities themselves were managed by semi-autonomous state corporations.

Project financing was largely undertaken by the governments themselves, with the budget being divided between current spending on wages and salaries and capital expenditure, which was regarded as a type of national investment. Such investment was either funded from tax revenue or through government borrowing, the latter being usually arranged through domestic bond issues if there was a local capital market, or through Euro-market financing if government paper was not traded domestically, and if domestic commercial banks could not be harnessed due to their limited resources. In the case of Euro-market funding the financing was either arranged through syndicated borrowing, which from the 1980s, increasingly took the form of floating rate notes, or by bond issues.

In both these cases the funding was usually United States dollar denominated, which implied foreign currency risk, as well as interest risk in the case of the syndicated loans and floating rate notes. Governments themselves had to either have the notes or bonds issued in their own names, or guarantee the loan if one of their state corporations was named on the financing instrument. As a consequence, once problems arose governments were immediately involved, with detrimental consequences for whole economies, as was apparently clear during the debt crisis which followed the Mexican default of 1982.

3. Islamic Evaluation of Project Risk

Such debt financing was not, of course, acceptable under the *Shar¬cah* law, even though states with majority Muslim populations widely had recourse to these arrangements. Both variable and fixed rate interests constitute *rib®* and as such are strictly *ḥar®m.* As the interest rates which represent the price of the project funding are determined exogenously, rather than being related to the returns on the project, this introduces an unacceptable element of risk, which is unjustified as it is entirely borne by the borrower rather than the lender. It is this asymmetry which is the cause for concern. This is not to imply that the lender is taking no risk, as there is a risk of default by the borrower or the banks involved in underwriting the finance, but there is no sharing of commercial risk as the project evolves over time.

It is worth stressing that the risk element included in the premium over the London Inter Bank Offer Rate (LIBOR), for Eurodollar borrowing, is related to country or sovereign risk rather than the commercial risks associated with a particular project. The latter is not priced into the interest charged, which can be viewed as reflecting macroeconomic conditions and expectations rather than microeconomic variables pertaining to the project itself. This divorce of lending rates from the capacity of the project itself to generate returns is what is regarded as unjust by Islamic economists. Information imperfections and asymmetries are also a cause for concern, but the basic problem is that it is the wrong set of information which is priced into the interest rate premium. There may be imperfect information at both the macro and the micro levels, but it is only the former which is actually utilised.

This problem arises both with fixed rate Eurobonds and variable interest syndicated borrowings and floating rate notes. The fixed rate borrowing terms are determined at the outset and introduce rigidities. Borrowers know what their nominal obligations are in money terms throughout the period of the loan, but this makes no allowance for project or inflation risk. With variable rates, there is uncertainty about both future nominal and real interest obligations, with changes in these obligations related to international financial developments in the Euromarkets and monetary and fiscal changes within the United States, neither of which may have much relevance to the project being financed.

The so-called Third World debt crisis which followed the Mexican default of 1982 was seen by many Islamic economists as a vindication of their critique of international borrowing on the basis of interest. It was the doubling of Eurodollar interest rates in the early 1980s in response to the tightening of United States monetary policy which triggered the crisis amongst the major Latin American and Eastern European debtor nations rather than the inherent lack of viability of the projects being financed.[2] Fortunately, there were few Muslim countries which had undertaken such commercial borrowing on a large scale, the exception being Algeria, where the economy also suffered from a declining ability to service its debt with the oil price falls. Indonesia's debt problem was manageable in relation to its foreign earnings, and in the case of Egypt, the most indebted Arab country, much of the debt was to the United States government rather than to the Euromarkets, the constraints being political rather than commercial. Nevertheless as Umer Chapra points out, debt is a problem in the Muslim world, and there has been borrowing for current as well as capital expenditure which is particularly unwise.[3]

4. The Privatization of Project Finance

Although the debt crisis was relieved by falling Eurodollar interest rates, the painful structural adjustment programmes that many debtor nations were forced to undertake resulted in a revaluation of the merits of projects being financed through debt instruments secured by government guarantees. The conditionality imposed by the International Monetary Fund under the terms of debt restructuring packages agreed through the Paris Club itself constrained state infrastructure spending, as capital projects were usually the first victims of expenditure cuts as governments struggled to balance their budgets.

The solution was not simply to replace debt with equity finance, as the latter brings its own difficulties, and the stock markets of developing countries are mostly insufficiently developed to absorb the huge equity placements necessary to fund infrastructure projects in any case. Equity finance has certainly had an increasing role to play, but only as one element of project financing packages. Each new infrastructure project can be undertaken using a range of ownership options, and it is the choice of ownership structure which determines the basic parameters for the financing.

Alternatives to wholly state-owned infrastructure facilities and utilities include joint-ventures with multinational companies, with majority or minority host government control under so-called golden share arrangements. Under such schemes, the foreign multinational provides the technical and managerial expertise and raises its share of the capital, either from internal company resources, or through borrowing under its own name. The host government raises its share of the finance, both in the domestic market in local currency through bond issues or bank borrowings or in dollars through international borrowings. Usually the latter will be designated as being specifically to fund a particular project, with the bond or note bearing the name of the project. This introduces a greater participatory element to the financing, as risk is related to the viability of the project itself rather than simply sovereign risk. However in practice, if repayment difficulties arise, the bond holder will not have a claim on the capital of project itself, as the bonds are not treated as preference shares. Financing difficulties will instead have to be sorted out by the host government. The major element of the cost of the funding is related to prevailing market interest rates, not project returns, which Islamic economists would favour.

The joint-venture itself is normally locally incorporated in the host country, with the government and the multinational sharing in the profits from the project according to their percentage stake in the venture. The multinational partner will expect its share in the profits to cover at least its financing costs, which will typically be lower than those of the host company government given the very favourable credit ratings of many multinational companies.[4] The host government will expect the revenue to cover the running costs of the project and possibly the servicing cost of the debt, but not necessarily the principle, which may be regarded as a sunk cost. With electricity generating capacity or a road or bridge, it might be possible to cover the entire cost if the electricity tariff or road toll is set at a high level, but this may be regarded as socially undesirable, in which case writing off the states share of the debt principle may be regarded as worth the social benefit.

With projects involving infrastructure and utilities, the pricing regime for end users affects both the financing possibilities and the potential ownership structure. Multinational companies will not want to be involved unless there is the possibility of profitable pricing, but there may be resistance to substantial price increases for basic services such as electricity, gas or water or infrastructure charges levied through road tolls, airport taxes and similar duties. Discriminatory pricing which favours those on low incomes may be more socially acceptable, although determining the criteria for beneficiaries may be controversial and their identification potentially difficult. In practice, electricity, water and telephone companies in the West tend to discriminate in favour of high volume users by offering price discounts, which usually benefits businesses and their more wealthy customers rather than low income households.

With appropriate charging structures, Build-Own-Operate (BOO) and Build-Own-Operate-Transfer (BOOT) schemes have been instigated for a number of major infrastructure and utility projects.[5] Under such schemes a multinational company commissions the building of the project and manages the scheme either in perpetuity, subject to a renewable contract, or for a fixed time period. The multinational will have to agree on the charging structure with the government concerned or the state regulatory agency. In return, the company arranges all the funding itself at no cost to the government. In the case of BOOT schemes the ownership of the infrastructure or utility reverts to the government after a ten to twenty year period, by which time the multinational company should have covered its costs and made an acceptable profit.

By 1996, private funding for infrastructure projects was worth over $17.32 billion with a total of $42.8 billion agreed for future disbursement. Funding doubled over the previous year with over $12 billion agreed for Asian projects and $5 billion for the Middle East.[6] The banks were prepared to fund such amounts as the spreads over LIBOR were 120 to 125 basis points for project financing compared to a mere 10 base points over LIBOR for blue chip corporate loans. These higher rates reflect the perceived risk factors with project finance, which can go seriously wrong even for major projects in highly developed countries as the experience with the Eurotunnel rail link between Britain and France showed. Such experiences have meant that much attention is paid to contract details with modern project financing which implies high legal fees as well as bank arrangement fees. Nevertheless, such charges do not seem to have slowed the privatisation of project finance or deterred cash constrained governments which desperately need to upgrade utility provision and infrastructure.

5. The Asian Debt Crisis of 1997-98

Private project financing does not guarantee that there will not be difficulties in the repayment of borrowings as the Asian debt crisis of 1997-98 shows, but it is worth stressing the differences between this and the earlier Mexican debt crisis of 1982 and the latter Mexican economic difficulties in 1996.[7] The Latin American debt repayment difficulties of the 1980s were caused by rising Eurodollar interest rates as already indicated, whereas Asia's problems arose from currency exposure and domestic property speculation. Yet in the Asian countries the economic fundamentals were sound, while in Latin America and certainly in Africa, this was far from being the case.

When East and South East Asian countries started to undertake more ambitious projects in the late 1980s and early 1990s, it was the private sector rather than the governments themselves which played a major role. Private construction companies borrowed from commercial and investment banks in local currencies at market rates of interest, usually on a variable interest basis rather than through fixed interest funding. The investment banks often raised their financing through lower interest dollar denominated borrowing, as the difference between the higher local currency lending rates and dollar borrowing rates made such business attractive, although there were always the currency exposure risks. As long as property prices and rental values were rising, such lending was sustainable.

In 1997 the Asian property market moved into recession, and construction companies, initially in Thailand, but soon after in Malaysia and Indonesia, found they could not service their bank debts. This resulted in a crisis of confidence in banks and financing companies heavily exposed to the construction sector. Domestic interest rates rose, but this was insufficient to support existing dollar exchange rates, as many foreign exchange market dealers and businesses with substantial local currency holdings believed that depreciation against the dollar was inevitable. This created a severe problem for both commercial and investment banks which held local currency assets which were not being serviced, and arguably needed to be written down in value if not completely written off. At the same time, with local currency depreciation the dollar liabilities of the commercial and investment banks soared in local currency terms.

The currency mismatch of assets and liabilities was certain to trigger a financial crisis, which only recourse to external agencies, notably the IMF, could resolve.[8] The IMF duly stepped in to assist, but the funding for Thailand, Korea and Indonesia was conditional on financial reforms that Washington dictated which were arguably more in the interests of Western banks and securities houses than local institutions. It remains to be seen how the reforms which involve an even greater openness of Asian financial markets to international financial capital will work in the long term.

Inevitably, the Asian financial crisis of 1997-98 had an adverse effect on projects. The start of work on the Bakun Dam project in Malaysia was postponed, a project worth $4.6 billion, while the Bangkok mass transit project had to be put on ice, which would have required funds of over $3.7 billion. In Indonesia fifteen projects were halted pending a further review of the financing including eight power plants, four toll roads, an airport and a meteorological equipment project.[9] As a consequence the value of new projects funded in Asia fell from $76 billion in 1996 to $34 billion in 1997. World-wide project deals agreed fell from $223 billion in 1996 to $151 billion in 1997, although increased starts ups in Latin America and Eastern Europe failed to compensate for the Asian slowdown. Nevertheless the Asian projects are not being abandoned but merely delayed, and hence when economic conditions improve with financial restructuring there may be more project work than ever.

6. An Islamic Critique of Financial Reform and Privatization

From an Islamic perspective, the Asian financial crisis of 1997-98, just like the earlier Mexican debt crisis of 1982, can be blamed on reliance on *rib®*-based finance. The divorce of the financing from the underlying projects being undertaken implied that the funding was in no way participatory, as the banks and financial institutions providing the dollar loans were more concerned with the credit ratings of the domestic financial intermediaries than with the actual projects being funded. It was the isolation of the ultimate fund providers from the fund users and the consequent breakdown in information flows that lay behind the crisis. In contrast with participatory finance, the investor shares in both the commercial risk of the project and the currency risk.

Furthermore, those directly involved in many of the projects, especially the property developers, were more concerned with making speculative gains from the ventures rather than making a legitimate contribution to economic advancement. There was an element of *ghar®r* or deception in what they were doing which is prohibited under the *Shar¬ᶜah* law, as the projected returns from the projects were based on over-optimistic assumptions about property prices and rental values. In some cases, not only were funders misled but there was also genuine self delusion as project developers fell victim to their own exaggerated sales pitches to impress their backers.

The solutions proposed by the IMF to open up the financial systems of countries such as Indonesia, and introduce greater transparency and professionalism into project finance are not necessarily in conflict with the objectives of Islamic economists. Some of the best respected contemporary Islamic economists such as Zubair Iqbal and

Abbas Mirakhor, authors of an influencial report on Islamic banking in Iran and Pakistan,[10] have themselves worked for the IMF and made important contributions to policy debates within the institution. More open and transparent financial systems facilitate the involvement of institutions such as the Islamic Development Bank. It has undertaken co-funding of projects with the World Bank in a number of Muslim countries, and despite differences in funding methods, this cooperation has been deemed useful for all parties.

In so far as privatization involves a greater degree of participatory finance, it may be regarded as preferable to state funding from an Islamic perspective. The latter at best crowds out or even eliminates financial market transactions, effectively nationalizing the *muḍ®rib* function, and replacing it with a bureaucratic decision-making process which is more administrative than entrepreneurial. The state has an important role to play in an Islamic economy, but the prime task is to safeguard social justice, not to assume ownership rights over productive resources. *Shar¬cah* inheritance laws create a just framework for the inter-generational transfer of property. Also legacies to the *waqf* are a matter for individual conscience, not state coercion.

Islamic economics should not, however, be regarded as more sympathetic to capitalism than socialism, rather both types of secular economic organization are seen as at variance with the Islamic vision and guidelines for a good life. A market economy is not necessarily a capitalist economy, as *rib®* finance, which is the basis of accumulation under a capitalist system, is unacceptable. Furthermore, the speculative nature of some equity finance increases the case for state intervention, especially where *ghar®r* or deception is involved, but this can be viewed as an argument for regulation of financial markets rather than their abolition.

Private ownership of resources may be regarded as the norm, but many Islamic economists have recognized the case for state control of natural resources such as oil so that they can be used for the benefit of the entire Muslim community.[11] Where the government itself finances capital formation, this obviously confers ownership rights for the state, but as already indicated, fewer governments of Muslim states are in a position to provide such financing today.

7. Discounting Under the *Shar¬cah* Law and Islamic Project Financing Techniques

The calculation of net present value of different projects has long been a commonly accepted means of deciding which projects should be given priority and which should be postponed or abandoned.[12] From an Islamic perspective there is concern when the discount rate is simply equated with the market rate of interest, as given the prohibition of *rib®* it could be argued that discounting should also be forbidden. There has been much discussion of this issue by contemporary Islamic economists, but the position was clarified in a pioneering study by Muhammad Anas Zarqa who concluded that discounting is permissible in Islam in principle, as this is unconnected with lending or borrowing on the basis of *rib®*.[13] The discount rate can be equated with the social rate of return in a Muslim society rather than the market interest rate, a technique which many economists favour in any case, as interest is constantly changing as a consequence of monetary policy or developments in the market for loanable funds whereas the social costs and benefits of a major project are a long-term issue.

Fahim Khan was concerned that the implication of discounting was that money had a time value.[14] If it is this element of interest which is objectionable from an Islamic perspective, this would also mean that discounting was not legitimate under the *Shar¬cah* law. He concluded, however, that the recognition of the time value was permissible in Islam, as Islamic banks were allowed to provide a higher profit share to depositors who accepted longer periods for minimal notice of withdrawals. It is the elements of risk and the inconvenience in having to give notice of withdrawal that justify the higher return, not simply the passage of time. This also applies in the case of future cash flows in relation to more immediate returns.

Ridha Saadallah agrees with Khan, and goes on to argue that monetary and economic instability are major defects of the contemporary interest-based financial system.[15] It is the outcome of interest that should be condemned, not all the inherent factors within it which can be accounted for separately.

Project financing involves both short-term funding of inventories and less valuable items of equipment as well as longer term construction and capital goods acquisition. For the former, all too often Islamic banks take a defensive position, the aim being to use techniques such as *murab®ḥah* mark-up finance which are designated as acceptable under the *Shar¬cah* law, but which mimic conventional financing, the assumption being that to do anything more radical would be to risk moral hazard. This assumes that there is a trade-off between economic efficiency and justice, which may not be the case. Indeed in an ideal Islamic society such conflicts may not arise if all believers follow the *Shar¬cah* law. It is imperfections which cause social disequilibrium and economic injustice, but as these reflect human shortcomings, the struggle between right and wrong is unending.

In the financial sphere, this may be interpreted in terms of the conflict between *rib®* and Islamic financing, which may persist in a global economic context where Muslims, despite their number, are a minority with little control over the levers of economic power. It may also persist within a pluralist society, as most Muslims live in countries where there is no Islamic exclusivity, and an entirely Islamized economic system may not be accepted by other groups. This, however, does not mean that Muslims must despair of ever achieving a degree of economic justice. Rather it simply implies that Muslim financing instruments will exist alongside conventional financing, and that even co-financing may be possible. The challenge is to ensure that the integrity of Islamic financing is preserved in such circumstances.

For example the mark-up on *murab®ḥah* financing, may have to be competitive with the interest rate terms offered by conventional banks in so far as the financial market in a pluralist society is integrated.[16] This does not imply that the mark-up is interest determined however, as that would assume that Islamic banks are merely passive price takers rather than price makers. Indeed, it is the conventional banks which are more likely to be the price takers, if interest is determined through government monetary policy. The Islamic banks, in contrast, have more freedom to determine their mark ups, the justification for these being the risks involved as the bank acts as a principal in a *mur®baḥah* transaction rather than as an agent.[17]

For the longer term components of project financing, Islamic banks dealing with Muslim clients may have advantages over their conventional counterparts. Good information is crucial if the risks involved in long-term project finance is to be reduced, and where funding agencies are divorced from the firms actually undertaking a project, moral hazard problems may arise. Such a divorce is much less likely if Islamic techniques of participatory finance are used, as the funding agency will be constantly monitoring the progress of the project.[18] Full-fledged Islamic alternatives to bid bonds and performance bonds have yet to be developed, but penalty clauses can be built into contracts covering Islamically funded projects so that the investors are compensated if there is a delay in project completion or the standard of contractor's work is unsatisfactory. There will always be some uncertainty nevertheless, hence techniques such as sensitivity analysis may need to be used to work out the implications for the project financing if various eventualities occur. Good financial reporting reduces moral hazard problems, although Islamic economists such as Seif I. Tag El-Din are probably overoptimistic about the extent to which moral hazards are reduced with modern business corporations.[19]

Muhammad Anas Zarqa has addressed the issue of how infrastructure projects can be undertaken that cannot be financed on a profit-sharing basis because they do not generate an income stream. He proposes a scheme based on *istisn®'* (or commissioned manufacture)[20] financing involving a sales contract for commissioned or pre-ordered production.[21] Such schemes were used in Malaysia in 1995 and 1996 to finance the PUTRA light railway transit project, with the financier making an advance purchase for a stake in the scheme for RM1 billion and the financee paying a mark-up in instalments every quarter over a four year period until the project was completed. On completion, the financier takes over the ownership stake, but then leases the light railway to the operator under an *ij®rah* scheme.[22]

The workings of this type of scheme are similar in some respects to BOOT arrangements, with the investor/contractors who build the project selling it on to the public sector commissioner on completion, with payments being made in instalments for the duration of the project, and possibly following completion, until the deeds to the project are handed over. The price the state agency pays includes a pre-determined profit margin which covers the cost of the financing. It should be noted that with BOO and BOOT schemes, the financier will make less profit than with an variable interest-based financing scheme when interest rates are rising, and more profit when market interest rates are falling. With *istisn®'* financing there can be some scope for changing the charging structure if the banks profit mark-up rises during the duration of the project.[23]

The Hub power project in Pakistan was financed using a variant of the *istisn®'* technique which should perhaps be subject to further *fiqh* scrutiny. The 1,292 megawatt oil-fired power station 40 kilometres north-west of Karachi was completed on schedule and within budget with the World Bank participation in the financing.[24] Mansoor Khan points out that this project had significant involvement from Islamic financing institutions, including the Al Rajhi Islamic Bank, which provided $92 million for some of the initial work and a consortium of four Islamic Banks which provided $65 million for a transmission line which was part of the project.[25] The consortium's involvement is worth describing in detail to illustrate how the financing works. Under the terms of the Islamic financing agreements the lessee entered into a contract with the seller/supplier as agent of the lessor, in this case the Islamic bank consortium. Once the equipment was delivered, the consortium, as lessor, paid the purchase price directly to the transmission equipment supplier plus other sales expenses. The lessee, the local electricity utility, agreed to pay the consortium, as lessor, twenty rental instalments over a five year period, after which the ownership of the equipment passes to the power company. The local electricity utility provided a guarantee for the payments period while the central bank provided a currency repatriation undertaking as the financing was in US dollars.

There are a range of alternatives to *istisn®'* financing which can be used to secure funding for BOO or BOOT schemes. One of the most promising is *muḍ®rabah* or *muq®raḍah* contracts, which are a type of Islamic bond issued by a Muslim government sponsoring a project in its capacity as a *muḍ®rib*.[26] In Malaysia, there are a number of Islamic securities that can be used to back BOO or BOOT schemes including *Mur®baḥah* Notes Issuance Facilities (MuNIFs) and *—uk,k* Notes Issuance Facilities (—aNIFs) which are traded instruments on the basis of *bay*[c] *al-dayn,* deferred sale obligations.[27] Such securities are unacceptable to many Arab *fiqh* scholars because of the uncertainties involved and the possibility of agreements not actually being carried through in practice. In these circumstances, *istisn®'* financing may be preferred.

8. Conclusions

There seems to be agreement between Mansoor Khan and Muhammad Anas Zarqa that there is an important role for *istisn®'* in Islamic project finance. The Hub power project demonstrates how this can work in practice. This, however, represents only one financing solution, as other instruments are available, such as *mur®baḥah, muḍ®rabah* and *mush®rakah*. Furthermore although there are similarities between *istisn®'* and BOOT schemes as already pointed out, there are also differences. In the case of *istisn®'* it is the Islamic bank that acts as lessor and controls the project until it is handed over. The contractor is merely the supplier. With BOOT, it is the contractor who controls the project until it is handed over, usually some years after it is completed. With *istisn®'*, the cost of the lease can be recalculated each year in line with the bank's current profit mark-up.

This is not the case with BOOT schemes where the pricing regime is agreed between the contractor and the utility for the duration of the project, although there may be some scope for price adjustments to allow for global changes in energy prices.

Given the increasing reliance on private sector funding for major infrastructure projects in Muslim countries, Islamic banks and finance houses can reasonably expect to become involved to a considerable extent in such business. There is, however, a need for further thinking regarding the development of financial instruments that can be both more participatory, hence *Shar¬cah* compliant, and meet the financing requirements of BOOT schemes as well as other similar ventures. Islamic alternatives to conventional project finance are now attracting the attention of major institutions such as the Chase Manhattan Leasing, the International Finance Corporation, the ANZ Investment Bank and the ABN AMBRO Bank.[28] It is the financing details which matter, and these types of organizations are needed, together with those with specialist knowledge of exactly what is required from a *Shar¬cah* perspective, if the challenges of providing Islamic project finance are to be meet. This would achieve two desirable objectives: more justice and *Shar¬cah* compliance, and the consequent economic benefits of participatory schemes alluded to earlier.

Endnotes

1. Malhotra (1997, 33-5).
2. Wilson (1988, 178-91).
3. Chapra (1992, 300).
4. Many Islamic economists favour foreign direct investment, but there is a natural preference for it to be undertaken by Muslim companies. See Siddiqi (1996, 115).
5. BOO implies that the foreign company owns and controls the facility for the life of the venture, although not necessarily the land on which the facility is located. With BOOT, the facility and the land are owned by the investor for a fixed period, after which the ownership reverts to the host

government or host country company.
6. Fleming (1997, 1 and 9).
7. Martinez (1998, 6-9).
8. IMF Staff (1998, 18-21).
9. Taylor (1998, 13).
10. Iqbal and Mirakhor (1987).
11. Wilson (1998, 1-20).
12. Brealey and Myers (1981, 61ff).
13. Zarqa (1983).
14. Khan (1991, 35-46).
15. Saadallah (1994, 98).
16. Mirakhor (1996, 35-46).
17. For a very clear discussion of the legal implications of *mur®baḥah*, see Vogel and Hayes (1998, 140-3).
18. Sarker (1995, 1-16).
19. El-Din (1991, 49-66).
20. Vogel and Hayes, *op. cit*., 146-9.
21. Zarqa (1997a, 67-74).
22. Dato' Hashim (1996, 7-9).
23. Zarqa (1997b), 239-40.
24. http://www.worldbank.org/html/dec/Publications/Abstracts97/04jud/infa10.html
25. Khan (1997, 13-6).
26. Malaikah (1998, 11-4).
27. Vogel and Hayes, *op. cit*., 114-25.
28. These institutions, together with the Faisal Bank of Pakistan, were involved in a conference on Islamic Leasing and Project Finance in London in March 1998 chaired by Richard Duncan and organized by the International Communications for Management.

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MACROECONOMIC INSTABILITY, FINANCIAL REPRESSION AND ISLAMIC BANKING IN SUDAN

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Abstract

This article examines the practice, problems and potential of Islamic banking in Sudan. The study demonstrates an unprecedented decline in both financial and real variables. It argues that the activities of Islamic banks in the country are constrained by the macroeconomic environment in general and repressive monetary and credit policy in particular. The paper concludes that when such constraints are removed only then the Islamic banking system may make a meaningful contribution to financial and economic growth in Sudan.

1. Introduction

Theoretical questions about how well an Islamic financial system can be and the role of monetary and fiscal policies were extensively analyzed by Khan and Mirakhor (1990). It is often contended that the Islamic "profit-and-loss-sharing" instruments are

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likely to reduce savings due to increased risk. It is argued that whereas savers in the conventional financial system face only inflationary uncertainties, those in the Islamic counterpart are subject to uncertainties pertaining to both the rate of inflation and the nominal rate of return on deposits.[1] However, it has been counter argued that, the question of whether uncertainty lowers the rate of savings relies on the assumptions made about the utility function and its risk properties; the degree to which the future is discounted, the income and substitution effects and on the relationship between uncertainty and returns. It was consequently concluded that the effect of Islamization on savings is at best ambiguous.[2]

As regards investment, the Islamic banking system is assumed to operate as an equity-based market with depositors representing shareholders and banks as partners who provide no guarantee on the rate of return or shares value. As a result, it is hypothesized that there will be a tendency of decreasing risk-aversion on the part of the Islamic banks since their income becomes a function of investment's yield.[3] The Islamic system may also be more adaptive to the requirements of new and innovative entrepreneurs since there is less need for collateral. Meanwhile, project monitoring implied by Islamic mechanisms will ensure that banks either act as entrepreneurs themselves or provide valuable technical and managerial support to investors. This would undoubtedly enhance the growth of entrepreneurial talents and hence fosters real growth.

However, Islamic financial arrangements may restrict investors' choice of project, raise the cost of intermediation, and reduce the array of indirect monetary instruments available to monetary authorities to control bank credit and money supply. Moreover, as Sattar (1989) observes conceptually Islamic finance implies the absence of interest-based government bonds and thus eliminates an important source of debt financing of budget deficit. Since all interest-based instruments of monetary management do not exist, monetary and fiscal policy may no longer be independent and budget deficits become synonymous with monetary expansion.

In Sudan, the first Islamic bank commenced operations in 1978 and as from 1990 the entire financial system has been legally bound to adhere to Islamic principles of finance. This paper describes the experience of Islamic banking in Sudan, and attempts to analyze the constraints imposed by deteriorating macroeconomic environment and restrictive monetary and financial policy on the activities of the banking sector during the period 1970-1995. The analysis is conducted within a "before and after" framework that does not involve formal testing of the direction of causation[4] between macroeconomic instability and Islamic banking practices. This approach is nonetheless justifiable because theoretically Islamic banking is believed to be conducive to financial stability and at least consistent with Keynesian or Classical macroeconomic models in terms of the link between financial variables and macroeconomic stability.[5] Indeed, in a model of an Islamic macroeconomic system, Sattar (1989) shows that macroeconomic instability is likely to originate from the real sector, especially the government sector, rather than the financial sector.[6]

The next section contains a brief discussion of the evolution and main financial instruments used by Islamic banks in Sudan. This section also examines the impact of Islamic banking on financial deepening and widening as well as on the saving-investment process. The nature of macroeconomic environment and monetary and credit policy and their possible influence on the behavior of banking institutions in Sudan are examined in Sections 3 and 4 respectively. Finally section 5 gives some conclusions and policy recommendations.

2. The Evolution and Performance of Islamic Banking in Sudan

The emergence of Islamic banks in Sudan has been associated with certain economic and political developments. The banking sector which was dominated by government-controlled and foreign banks used to offer little access, especially to new and relatively small scale, indigenous enterprises. Thus, local business groups were eager to penetrate the banking sector not only as a form of investment perse, but also for the services and credit facilities they expect to have in the future. At the same time, political developments in the country have been increasingly overshadowed by revival of Islamic ideals, which were then manifested in the establishment of Islamic enterprises, including banks. The first bank, The Faisal Islamic Bank, was incorporated in 1978, and its immediate business success provided the impetus[7] for five other Islamic banks to be opened between 1982 and 1987. As from 1990 onward, the entire financial system of Sudan has been instructed to observe the Islamic principles of finance. By 1988, there were 23 commercial banks[8] compared to just 5 commercial banks in 1972. After the full adoption of Islamic banking principles and relaxation of bank branches licensing policy in the 1990s, the number of banks decreased due to amalgamation of some joint banks, but the number of bank branches almost doubled from their 1990 total of 320, with many of the new branches being established in rural areas. To assess the experience of Islamic banking in Sudan, we first discuss the evolution of Islamic financial instruments. Second, we examine the impact of such instruments on the process of financial development in the country. Finally, we analyze the potential of Islamic banks to influence real development by bringing about a conducive structure of financial resources.

2.1 Islamic Financial Instruments in Sudan

In accordance with the Islamic principle of participation, Islamic banks in Sudan have introduced an array of financial instruments to facilitate transactions on both sides of the balance sheet.

2.1.1 Sources of Funds

In addition to their own capitals and equities, Islamic banks raise funds by creating three basic forms of liabilities viz demand deposits,[9] saving deposits and investment deposits. Demand deposits are similar to current account deposits of conventional commercial banks. They bear no returns, but their holders receive a variety of services such as checking facilities. Although some Islamic banking models have argued for a 100% reserve requirement on demand deposits, Islamic banking in Sudan and elsewhere operates on partial basis.

Saving deposits differ from demand deposits in that they carry no service charges, their holders may be entitled to special borrowing facilities, and they earn profit/loss subject to certain maturity limitations. Investment deposits are normally held for the purpose of earning income and may not be withdrawn before the lapse of a certain period of time. They closely resemble business shares since their nominal value is not guaranteed and the returns on them are uncertain and variable. The bank acts as a financial trustee that accepts deposits and invests them on behalf of depositors in any form of financial arrangement that satisfies Islamic requirements. The only thing agreed upon in advance to the employment of funds in this deposits category is the basis on which profit/loss is distributed between the bank and the borrower, and between the bank and its depositors. The basis of distribution in the former case is normally the net profit/loss realized by the investor, and in the latter case is that realized by the bank, given the profit-and-loss sharing ratios as determined by the authorities. Since saving and investment deposits represent the base for medium and long-term or more generally development financing, their share in total bank deposits is critical to the success of Islamic banking in effecting real development.

2.1.2 Lending Instruments

Over the years Islamic banks in Sudan have used a variety of lending instruments some of which have been abandoned or changed in terms of significance.[10] Therefore the list below is by no means exhaustive.

The first lending instrument is *Mu¥®rabah*, which is a financial arrangement in which the bank provides all the necessary financial capital while the investor provides all human capital needed. The two parties share the uncertain profit according to an agreed formula. In the case of project failure, the bank and its depositors bear the entire financial loss, whereas the entrepreneur loses his time and effort invested in the project. In the life time of the project, the bank is the sole owner of it, and the borrower is the manager. *Mu¥®rabah* has traditionally been confined to commercial activities of short duration. Banks can make loans to customers directly or indirectly through a *Mu¥®rabah* (equity) company, the capital of which is provided by banks in the form of direct equity or through loans with equity features. The second instrument is *Mush®rakah*, which is a joint venture in which there is more than one contributor to the financial capital. The profits and losses are to be shared according to the respective capital contribution of each party.

The third lending instrument is deferred payment sale or mark-up (*Mur®bahah*) sale, which provides one of the means for banks to purchase a product and resell it on the basis of deferred payment, in instalment or lump-sum. The borrower (buyer) and the bank agree on the price of the product plus a profit margin. The fourth lending mechanism is purchase with deferred delivery (*Bay*ᶜ *al-Sal®m*), which enables banks to purchase goods at negotiated price, but to be delivered at some future date. The bank pays the seller the full amount at the time the contract is signed. *Bay*ᶜ *al-Sal®m* has been the most important instrument of formal lending in agriculture in the 1990s. It is extensively used by farmers to obtain the funds they need for agricultural operations against the promise of delivering an agreed amount of their future output to the bank.[11] The assets of the farmer can be used as collateral or security against fraud and negligence, but the lender would bear all due financial losses incurred in the operation.

The fifth instrument is leasing or hire-purchase, according to which the bank can purchase a commodity, and lease it to a borrower for a specified sum and for a certain period of time. The agreement can also provide for a lease-purchase of the commodity. In this case payments made by the borrower would include a portion which can be earmarked for the final purchase and transfer of ownership of the product. Over the period of the lease, both parties are subject to the risk of potential damage. Finally, service charges are legally allowed to be levied on loans or services rendered by banks. This method is particularly relevant in the case of consumption loans, overdrafts or small scale borrowing.

Besides financing investment through the above instruments, Islamic banks can undertake investment directly by establishing their own corporate enterprises. The bank will eventually be responsible for both funding and management.

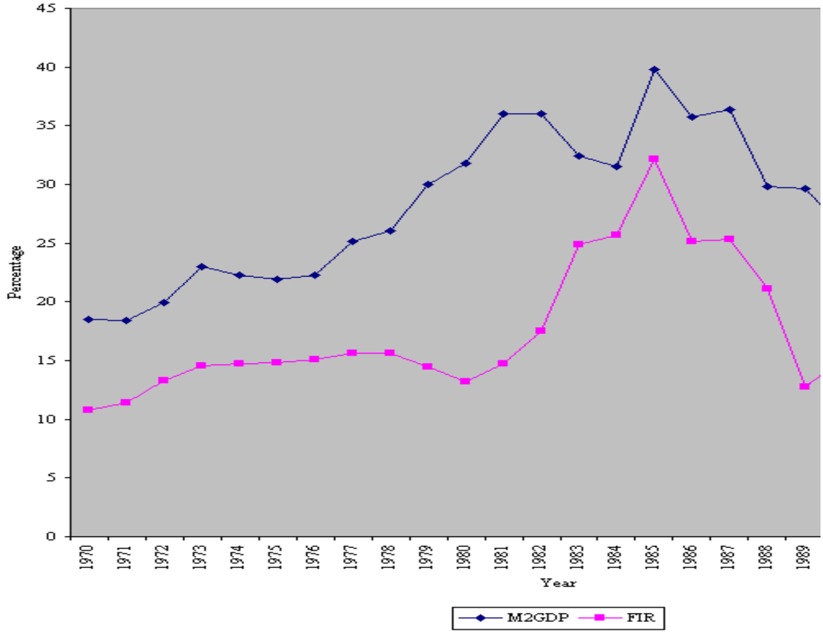
2.2 Islamic Banking and Financial Development

Financial development has two components; financial widening and financial deepening. The former refers to the accessibility of financial services and the spread of banking habits among the public, which depends largely on the geographical dispersal of banks. Financial deepening is concerned with the nature, range and sophistication of financial instruments used and innovations made in the course of attracting funds and extending credit. Traditionally financial development is proxied by the ratio of narrow or broad money (M1 and M2 respectively) to Gross National Product (GDP). However, as King and Levine (1993) and Demirguc-Kunt and Levine (1996) note this ratio indicates the ability of financial institutions to provide liquidity and not necessarily their role to allocate credit efficiently. For example, while a low M2/GDP ratio may indicate a high degree of sophistication of financial markets which allows individuals to economize on their money holdings (Bencivenga and Smith, 1991), it may also reflect financial dis-intermediation or portfolio shift from financial to real assets. The latter normally occurs under conditions of high inflation rates and macroeconomic uncertainty. In view of this, the literature has suggested the use of a number of additional indicators of financial development. These indicators are, first, the ratio of Quasi-money to M2 (or GDP), which was used by Demirguc-Kunt and Levine (1996) as an indicator of the degree of financial efficiency. For the financial system to raise increased longer term liabilities it has to be efficient and conducive to public confidence. The ratio of quasi-money to M2 (i.e. the Financial Interrelation Ratio, FIR) is particularly important in the context of economic development because it reflects the ability of the banking sector to create medium and long-term credit. Therefore, financial development is more likely to be growth-promoting, if it is accompanied by an increasing FIR.

Second, the ratio of total claims of deposits in banks to GDP (TBCGDP) is a measure of the level of development of the banking system. Third, the ratio of private sector credit to total domestic credit (PSCTC) or GDP is an indicator of both the degree of financial intermediation and efficiency in credit allocation. The share of the private sector in domestic credit is supposed to rise as the financial system develops and/or becomes more liberalized. Finally, the difference between bank lending and deposit rates (SPREAD) is considered as a measure of banking efficiency. This subsection discusses the evolution of the broad money to GDP ratio and the Quasi-money to M2 ratio, whereas the TBCGDP ratio and the PSCGDP ratio are examined in the next subsection in connection with resource mobilization. The spread variable is not considered because of paucity of information on effective bank lending and borrowing rates.

It was indicated earlier that the advent of Islamic instruments and relaxation of bank branches' licensing policies stimulated a notable increase in bank branches especially in rural areas. This reflects a rising degree of financial widening in Sudan. As in Figure 1, the period 1970-95 witnessed substantial changes in financial development in Sudan as manifested in the ratio of broad money (M2) to GDP and the ratio of quasi-money to M2. M2 is defined as the sum of cash outside banks plus demand deposits of commercial banks plus quasi-money. For the period prior to the incorporation of Islamic banks, quasi-money is defined as time and saving deposits of commercial banks. For the period when the banking system was partially Islamic, quasi-money included both time and saving deposits of traditional banks and saving and investment deposits of Islamic banks. For the post-Islamic banking period, quasi-money consisted exclusively of saving and investment deposits of commercial banks.

Figure 1: Some Indicators of Financial Development



The M2-GDP ratio grew steadily between 1970 and 1980, rising to the maximum of 40% in 1985 after a notable decline in 1983. Over this period, monetary policy was less repressive despite nominal interest rate fixing. Accordingly domestic credit and broad money grew rapidly. With accelerating inflation rate and strict private credit controls, the M2-GDP ratio declined sharply since 1985 reaching 24% by 1995. This notable dis-intermediation was accompanied by similar FIR behavior. The most remarkable drop in the two ratios occurred in 1992 as a result of an unprecedented tightening of credit policy in 1991. However, the ratio of profit-bearing deposits to total deposits, and hence

FIR, has been increasing since then. This rise was possibly due to high bank profits, resulting from the adoption of Islamic lending instruments, which also benefited depositors. Unfortunately, non of available publications gives data on profit/loss rates earned by banks or depositors, but survey information attests that bank profit rates were substantial in real terms.[12]

2.3 Islamic Banking and Resource Mobilization

To see how key banking performance indicators behaved after the abolition of fixed interest rates, Tables 1 and 2 report constant price and relative magnitudes of bank deposits and loans. Table 1 shows a continuous decline in bank liabilities and total deposits in both fixed 1987 price and relative to GDP, since the mid 1980s. This decline followed impressive increases in bank liabilities and deposits between 1970 and 1985. The average volume of total commercial banks' deposits in the period 1990-94 was about 52.4% of that in 1980-84, but the decline in total commercial banks' assets was less accentuate. This decline in private sector deposits is in contrast with the experience of Iran and Pakistan, where Islamic instruments resulted in an increase in such deposits.[13] The only notable positive element in Table 1 is the rise in the share of saving and investment deposits. This share rose from the annual average of 24.4% for 1970-74 to 38% for 1990-94.

Table 2 reports some interesting features of the growth and type of commercial banks' credit. In line with broad money and total assets and deposits, total commercial bank loans have fallen in both real and relative terms after reaching a peak around 1985. Tight credit policy since 1986 is at least partly to blame. In efforts to contain growth in money supply and inflation, ceilings on overall private credit have always been imposed. Under these ceilings, restrictions on the volume of individual bank's credit is also dictated on the basis of the bank's credit-resource[14] ratio, its cash-reserve ratio, and the extent to which it is involved in the financing of priority sectors over and above the minimum level set by the central bank. Meanwhile the required reserves

Table 1: Growth, Origin and Type of Commercial Banks' Deposits: 1970-1995

Indicator	1970-74	1975-79	1980-84	1985-89	1990-94	1990
1. Assets/Liabilities of Commercial Banks:						
a. in constant price	3053.1	5873.0	9056.9	8346.7	6365.4	-
b. as % of GDP	15.91	23.02	35.22	32.30	32.30	-
2. Total Commercial Banks' Deposits:						
a. in constant price	2098.3	4019.7	5635.1	5544.6	2954.2	2133.8
b. as % of GDP	10.9	15.75	21.90	21.45	14.73	14.03
3. Composition of Commercial Banks' deposits:						
a. Demand Deposit	75.62	75.95	70.74	63.02	62.18	37.76
b. Time and Saving Deposit* as % of total	24.38	24.05	29.26	36.98	37.82	62.24
4. Origin of Deposit:						
a. Government	1.61	2.86	1.81	12.1	4.11	4.36
b. Private Sector	98.39	97.11	98.19	87.9	95.89	95.64

Source : *IMF International Financial Statistics Yearbook* (1990 and 1996) and March 1997 monthly edition.

Notes : * Includes saving and investment deposits of Islamic banks, and consists entirely of these deposits in the post-Islamic banking period.
Base year 1987=100.

Table 2: Growth and Type of Commercial Banks' Credit and the Loan-Deposit Ratio: 1970-1995

	1970-74	1975-79	1980-84	1985-89	1990-94	1995
1. Total Credit:						
a. in constant price	2615.6	4266.0	4788.5	2960.8	1284.2	683.31
b. growth rate*	16.02	28.63	24.16	25.43	77.81	46.5
c. as % of total domestic credit	48.56	41.36	45.61	30.87	24.69	-
2. Type:						
Private sector (% of total)	73.86	73.69	81.67	96.67	97.61	98.76
Public sector (% of total)	26.14	26.31	18.33	3.33	2.39	1.24
3. The loan-deposit rate (%)	127.17	107.84	85.52	53.3	44.46	n.a.
4. Medium and long-term credit** (% of total)	-	14.75	23.96	24.63	23.10	n.a.

Source: as in Table 1.

Notes : *Nominal growth rates; **include real capital formation and working capital financing in all sectors.

ratio reached 30% by 1993 from the low level of 10% or less between 1970 and 1985. As a result, the credit-deposit ratio of commercial banks (line 3) decreased from 127% in 1970-74 to 44.46% in 1990-94.

However, Table 2 shows two positive developments. First, the share of medium and long-term lending in total bank credit has increased in the post-Islamic banking period. This was perhaps due to the fact that credit policy continued to encourage such type of credit while restricting the volume of other as well as total loans. Indeed, when much of bank lending capacity remained unused, the volume of medium and long term loans fell dramatically in real terms. Second, although total real bank lending was shrinking due to tight overall credit ceilings and selective credit controls, easy government borrowing from the central bank meant high private sector share in commercial banks' credit. This share amounted to about 98% between 1990-95. It is nontheless arguable that the policy of restraining bank credit is neither conducive to economic growth nor effective in lowering inflation. In fact, healthy increased lending to the private sector may in the long run lower inflation rate through increased investment and output.

There had been a considerable shift in the sectoral distribution of bank credit. Although since mid 1980s and up to date, credit policy has been designed to raise the share of priority sectors in total credit, it is only in the 1990s that this share increased significantly. Agricultural operations received the most remarkable rise in credit share, from less than 2% before 1990 to 36% in 1993. Several factors have contributed to this increase. The agrarian credit market has been influenced by macroeconomic strategies and policies which call for revitalization of agriculture and agro-industrial sectors to raise their contribution to national income. Increased demand for private credit initiated by these strategies was reinforced by the pull-out of the Central Bank from financing large public agricultural corporations. The notable horizontal expansion of banks, the initiation of consortium financing to agriculture by commercial banks, the widening of the activities of the Agricultural Bank of Sudan and the incorporation of the Farmers' Bank were all influenced by the strategies that led to increased agricultural loans since

1991. Moreover, it is believed that Islamic financial instruments such as *Bay*[c] *al-Sal®m* allow banks to make rewarding profits from increased lending to farmers. The real periodic rate of return on such loans was found to be 56% in 1995.[15] However, rural finance has focused almost exclusively on crop production.[16]

Although it has the status of a priority sector, the manufacturing sector failed to attract any notable increase in credit since the substantial decline in its share from 30% in 1975-79 to 17% in 1985-89. The export sector has maintained a stable share in total credit, while imports and local trade borne the brunt of restrictive credit policies.

3. Macroeconomic Setting, Instability and Implications

The key macroeconomic indicators[17] are set out in Table 4. Each of the five-year sub-periods of this table shows substantial current account deficit relative to GDP, particularly during 1990-1994. This deficit was notably small in the period 1984-89, because of austerity measures supported by an IMF stabilization program. The balance of payments position of Sudan is clearly critical, and as the country has always maintained low levels of foreign reserves (line 2), this position has frequently resulted in mounting internal imbalances, and rising prices. The rate of inflation[18] has well exceeded 100% for much of the 1990s. Up to late 1970s, the inflation rate was generally moderate. Following frequent devaluations (see line 4), falling terms of trade, and changing commodity composition of domestic consumption,[19] the rate of inflation rose to an average of 28% for the period 1980-84 and 42% for 1985-89. These factors added to unchecked government expenditure and borrowing from the domestic financial system. As a result, the inflation rate was raised to 116% in 1994.

The government finances in lines 7 and 8 depict worsening current budget deficit, let alone overall budget deficit. With the exception of the sub-period 1975-89, this deficit ranged between 1.34% and 6% of GDP, resulting in remarkably high rates of government borrowing from the banking system ranging between 11.3% and 18.2%

Table 3: Distribution of Commercial Banks' Credit by Economic Sector (%)

Sector	1975-79	1980-84	1985-89	1990	1991	1992	1993	1994
Agricultural Crop Production	0.030	0.040	1.19	4.43	18.87	34.01	35.37	29.25
Manufacturing	30.41	23.84	17.17	18.71	18.39	13.75	15.68	18.27
Exports[a]	29.53	24.1	35.43	24.85	17.97	17.23	21.88	22.41
Imports	9.48	16.10	5.88	2.82	1.98	1.12	0.01	1.10
Local Trade, Professional and Other loans	15.47	11.74	15.57	23.53[b]	19.43	11.57	6.03	5.62
Medium and Long-term Loans[c]	14.75	23.96	24.63	25.67	23.36	22.35	20.20	23.62
Total (av.)[d]	296.64	1099.80	3530.65	7417.71	14001.61	33107.7	52726.1	10072.6

Source : *Bank of Sudan Annual Reports* (1980 and 1988) and *The Economic Survey* (1991, 1994 and 1995).

Notes : [a]Include agricultural exports; [b]include capital investment by banks and some other medium and long-term credit; [c]encompass capital investment and working capital financing in various sectors; [d]Ls million. Totals may not add up to 100 because of rounding.

Table 4: Macroeconomic Indicators: 1970-1995

Indicator	1970-74	1975-79	1980-84	1984-89	1990-94	1995
Balance of Payments:						
1. Current account balance (% GDP)	-2.96	-3.66	-3.69	-0.99	-6.19	-3.57
2. External reserves[a] (% GDP)	1.96	0.54	0.33	0.25	0.55	2.92
3. Current private transfers[b] (% GDP)	0.49	3.04	5.01	3.27	1.55	0.02
4. Exchange rate[c]	0.35	0.35	0.99	3.25	111.56	526.32
Inflation:						
5. Rise in GDP deflator (% p.a.)	10.9	14.38	26.45	41.92	81.32	108.1
6. Rise in CPI (% p.a.)	7.8	18.62	28.07	44.37	101.75	116.75
Public Finances:						
7. Government current budget balance (% GDP)	-1.37	2.70	-1.96	-5.99	-3.94	-0.97
8. Public sector borrowing from the banking system (% GDP)	11.23	18.34	17.26	18.44	18.18	n.a.
Monetary Indicators:						
9. Broad money (M2) (% GDP)	20.43	25.08	33.56	34.26	25.44	22.47
10. Growth in broad money (M2) (% p.a.)	19.67	28.82	30.97	41.24	80.24	15.41
11. Growth in total domestic credit (% p.a.)	20.23	33.06	24.22	41.11	69.63	n.a.
12. Growth in credit to the public sector	16.71	40.37	31.14	51.00	75.78	-
13. Share of private sector in total domestic credit (%)	35.87	30.51	36.76	29.86	24.11	-
Investment, Saving and Income:						
14. Gross domestic investment (% GDP)	12.95	17.05	16.40	12.38	13.34*	n.a.
15. Gross domestic saving (% GDP)	11.88	8.55	4.10	6.27	1.95*	n.a.
16. Real GDP growth rate (% p.a.)	5.32	6.87	2.56	0.58	5.85	-2.41
17. Fixed price per capita GDP (1987=100)	1167.5	1515.3	1423.4	1238.1	1257.1	1070.0

Source : All financial and balance of payments data is obtained from the *IMF International Financial Statistics* (Various issues), real data is extracted from the *World Tables* (1990 and 1996) and the *Economic Survey* (1991, 1994 and 1995), Ministry of Finance, Khartoum.

Notes : [a]excluding gold reserves; [b]as from 1979 these are identical to workers' remittances; [c]period average Sudanese Pounds per US$; *calculated for 1990-91 only; Base year = 1987. Unless otherwise indicated, all figures represent period averages.

of GDP. This may be compared to the rate of similar government borrowing of less than 1.7% in Kenya over the period 1969-88.[20] The government is apparently unable to curtail its current spending, although social and economic expenditure has fallen dramatically in recent years. The 1990s witnessed massive retrenchment of civil servants. Yet the unstable political and administrative structures, frequent establishment and change of states, and the civil war in the South have contributed to mounting public spending. Thus the notable improvements in the tax system, where tax revenue rose at the average annual rate of 23% in the 1990s, failed to reduce public deficits to sustainable levels.

Line 10 of Table 4 shows an increase in the nominal growth rate of M2 from the average of 19.67% in 1970-74 to 80.24% in 1990-94. This rate was quite similar to that of total domestic credit (line 11), which in turn, show an ever rising share of government borrowing. The rate of growth in government domestic borrowing (line 12) is even more closer to M2 growth rate. Meanwhile, although the private sector assumed an increasingly important role in the economy over the period considered, its share in total domestic credit dropped from 36% in 1970-74 to 24% in 1990-94. This drop was the consequence of repressive credit policy (see section 4).

Finally, Table 4 displays the national accounting indicators in lines 14-17. The Gross Domestic Investment (GDI) rate declined from 17% in 1975-79 to 13.34% in 1990-94. In addition to the effect of falling income and saving, this possibly reflects deteriorating investment environment and heightened uncertainty, especially during the 1990s period, due to unstable macroeconomic policy, high public deficits, high inflation rate, collapsing domestic currency market, and political instability. Subsequent low income and perhaps also low incentives led to record low Gross Domestic Saving (GDS) rates between 1985 and 1995. The GDS rate declined from 11.88% in 1970-74 to the average of 1.95% in 1990-91, and was even negative in 1985 and 1991 drought years.[21]

The average real GDP growth rate conceals considerable year-to-year fluctuations. This rate rose from -1.5% in 1990 to 11.3%, 7.5%

and 5.4% in 1992, 1993 and 1994 respectively.[22] The only plausible explanation of these changes in GDP growth is in terms of rainfall as the economy is dominated by agriculture and agricultural output is largely rain-driven. However, the ups and downs in GDP growth rate have failed to halt steady decline in real per capita income (line 17) since the 1975-79 period. In constant 1987 US dollars per capita GDP fell from the annual average of 474 in 1970-74 to 354 in 1995.

To sum up, over the last decade the economy of Sudan was characterized by severe macroeconomic instability as indicated by high and accelerating internal and external imbalances, rapid exchange rate depreciation, phenomenal rates of growth of money supply and hyper-inflation. Macroeconomic instability has influenced lenders behavior in the direction of short-term loans, while at the same time reduced the volume of resources mobilized by banks through lower income and negative real rates of return. This can be a major cause of observed trend of financial disintermediation. The performance of the economy suggests a limited role for the financial system unless it is equipped to play, in Patrick's (1966) terms, a strong supply-leading rather than a demand-following role. Even in such a case, however, the banking system was subjected to a possibly more binding constraint in the form of restrictive monetary and credit policies.

4. Monetary and Credit Policy

Monetary and financial policy has, since the early 1980s, been increasingly used in developing countries to meet the challenges of both short-term stabilization and long-term adjustment.[23] In Sudan, however, monetary policy was consistently used to simultaneously attain both stabilization and growth objectives. Yet, these objectives may not be complementary. For instance, while stabilization requires containment of bank credit, growth requires increased mobilization and efficient utilization of financial savings.

The emphasis and tightness of monetary and credit policies have changed over time, from loosely stated objectives and lax control in the 1970s to comprehensive regulation during much of the 1980s and 1990s. The array of usually available instruments consisted of nominal interest rates and later PLS ratios, qualitative and quantitative credit control, cash reserve ratios of commercial banks, and cash margins on certain loans and bills. Because of the underdeveloped nature of the money market the interest rate was not considered as an important instrument of monetary policy. Changes in the reserve ratio were quite infrequent. Consequently, credit rationing and issue of directives were the main instruments used by the bank of Sudan to implement its monetary policy. In fact, credit ceilings and selective credit control techniques were the most important means of monetary management in Sudan; when bank lending and lavish private spending were seen by government in mid-1991 as the main causes of accelerating inflation and deteriorating standards of living, drastic measures[24] were introduced to facilitate direct control of the financial market in particular.[25] This policy, however, shook public confidence in the financial system culminating in a run on banks, which forced the government to partially reverse some of its policy measures. By early 1992, several price controls, including exchange rate controls were eased, and the government embarked on a home-grown stabilization program. Nevertheless, economic instability and uncertainty remained to be high, while monetary and credit policy continued to be repressive.

Interest rate policy had, prior to 1984 relied on fixed nominal rates of interest, which were falling in real terms. Up to 1990, deposit rates varied between 6% and 24% while lending rates ranged between 10% and 27%. The inflation rate during this period ranged between 1% and 67%, resulting in negative real rates for most of the period. In 1990, interest rates were replaced with profit and loss sharing ratios that specify the manner in which profit realized from bank-financed activities are to be divided between banks and borrowers on the one hand and banks and depositors on the other. The banks' share in borrowers' profits was fixed at 48%, of which 44% to be distributed to depositors. The exact rate of return to each party cannot be determined ex-ante. There is no available information on the exact returns on deposits during 1990-94, but it has been argued that bank lending was focused on short term loans with real rates of return that are higher than those prevailed prior to 1990.[26]

Credit policy has since the early 1980s been progressively restrictive concerning the size and sectoral allocation of credit. Quantitative credit control consisted of direct ceilings on bank lending to the private sector, with the hope of curtailing money growth and inflation. Meanwhile, selective credit control was implemented to enhance economic growth by means of channelling credit to perceivably more productive sectors and related activities. The priority sectors encompassed agriculture, manufacturing, export, and transport, for which medium and long-term loans were particularly encouraged to finance working as well as fixed capital.

In the late 1970s, and as part of a stabilization program inspired by the International Monetary Fund, commercial banks were directed to extend at least 10% of their total advances in the form of development loans. As from 1986 onward, this policy was further tightened to limit commercial banks' advances under the ceiling as follows: 30% to the export sector; 25% to working capital in industry; 35% in the form of development loans; and the maximum of 10% to local trade and other types of lending. To reduce the risk inherent in agricultural credit in particular, consortium financing was encouraged. In 1990, monetary policy stipulated 80% of total bank ceiling for priority sectors, with 40% of the ceiling for agriculture alone. Priority sectors share was further raised to 90% and agriculture to 50% in 1993. This policy continued although overall credit ceilings were relaxed in October 1994.

Reserve requirements policy had also been restrictive. Thus, while the reserve requirement ratio remained below 10% throughout the 1970s, it was raised to 12.5% in 1985, 18% in 1988, 20% in 1990 and 30% in 1993, but reduced to 25% in 1994. With effective credit ceiling the reserve ratio is in practice redundant. Similarly, other instruments of indirect monetary control such as open market operations and the discount rate, which work through the reserve money side are also virtually redundant. For the former policy to work, there needs to exist a relatively well organized financial and securities market,[27] and the bank rate was hardly used since commercial banks often suffered from excess liquidity rather than the reverse. Under these circumstances, monetary authorities have frequently referred to additional methods of direct monetary control including prohibition of inter-bank lending.

The discussion in the previous section indicated that government borrowing was the major source of macroeconomic instability, whereas the analysis in this section blames restrictive monetary policy for significant contraction in development and other financing in the private sector in the 1990s. The effect of these policies on financial intermediation, private investment and aggregate demand, may in the long run defeat both the stabilization and growth objectives. This effect is believed to be exacerbated by institutional rigidities that do not permit enough flexibility for banks to introduce innovative instruments especially in relation to rural finance.[28]

5. Conclusions and Policy Recommendations

The analyses in this paper indicated a negative trend of financial development and intermediation since the full adoption of Islamic banking principles in 1990. There has been a decline, in either real or relative magnitudes or both, in all key indicators of banking performance. Poor banking performance was associated with an unprecedented decline in real economic activity, a highly unstable macroeconomic environment, and repressive monetary and credit policy. However, these policies have only circumcised banking and finance within the private sector, while massive inflationary finance of public deficits seems to be a major source of economic instability and uncertainty.

Of paramount importance to the success of Islamic banking in particular and achievement of sustainable growth in general is macroeconomic stabilization and structural adjustment. A moderate and stable inflation rate and reduction of public deficits are the major prerequisites. Exchange rate and trade liberalization should be deepened in order to increase trade, and production efficiency in various sectors. This study calls for the following main policy measures. First, curtailment of the high levels of inflation thwarting the efforts of banks to mobilize saving and engage in medium and long term lending. Second, the dismantling of direct credit controls. (To counter possible adverse consequences of this policy, banking supervision ought to be strengthened.) Third, increased mobilization of savings especially in rural areas through horizontal expansion of banking services. Fourth, market-based policies and measures has to be designed to encourage lending to sectors other than agriculture. Finally, encouragement of innovative lending arrangements such as group lending in rural areas which are part of the traditions of rural communities. However, as many observers suggest "national economic and social reforms will not induce the needed positive impacts without peace and political stability."[29]

Endnotes

1. De-Rosa (1986).
2. See Khan (1987).
3. Ulhaque and Mirakhor (1987, 158).
4. Since the paper focuses on the impact of macroeconomic instability and repressive monetary policy on the performance of Islamic banking institutions and as argued hereunder the use of econometric techniques such as the Granger test is not theoretically warranted. It is also empirically not meaningful because of the short experience of Islamic banking in Sudan.
5. See Khan and Mirakhor (1987, 181) and Zuberi (1992, 1080).
6. Sattar (1989, 126).
7. For a detailed discussion of the political and economic factors behind the appearance of Interest-free banking in Sudan see Shaeldin and Brown (1988).
8. In addition to these there are 4 specialized banks and a post office savings deposit bank.
9. These deposits are known as *Qarḍ Ḥasan* deposits in Iran and as Trust Deposits in Jordan.

10. See Attia (1986) and Elhiraika and Ahmed (1998).
11. Elhiraika (1996).
12. *ibid*.
13. Khan and Mirakhor (1990).
14. Resources include total deposits, paid-up capital, reserves, and margins on letters of credit.
15. Elhiraika (1996).
16. *ibid*. and FAO (1997).
17. The real sector data shows some unexplained changes in some years, but the financial data is generally more reliable, particularly when long-term trends are covered.
18. It is often argued that official records underestimate the rate of inflation. If we take exchange rate depreciation as an example we note that the domestic price of the US$ increased by an annual average of 500% between 1990 and 1995.
19. Hussain (1985).
20. See Killick and Mwega (1993).
21. See World Bank (1996, 28).
22. *ibid*., 33.
23. Page (1993).
24. These measures included restrictions on withdrawals even from private demand deposits.
25. Ministry of Finance (1991).
26. Elhiraika (1996).
27. As Ulhaque and Mirakhor (1987) demonstrate this market might be a necessary condition for Islamic banks to avoid liquidity problems. The Government of Sudan has passed the Act for a securities market in 1994, and its operations started in 1995. It remains to be seen if it can get off the ground.
28. FAO (1997, 151).
29. *ibid*., 6.

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INVITED ARTICLE

THE THEORY OF THE ECONOMICS OF ISLAM (II)

The Economics of Tawḥ¬d and Brotherhood: Philosophy, Concept and Suggestions for Policies in a Modern Context

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1. Ways and Means

In the second part of this paper, after we have laid down the basic concepts and principles of Islamic economics, we will examine the ways and means to establish and benefit from this philosophy. First, we will try to identify the economic philosophy behind the major policies employed by the Prophet (s.a.w) at his time. We will also try to identify the basic economic characteristics of our contemporary world and the way in which we can benefit from the Prophet's (s.a.w) policies to achieve the same goals.

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Editor' Note: This paper is the second of a two-part series, and is largely based on the author's book, *Nazariyy®t al-Isl®m al-Iqtiṣ®diyyah* (The Islamic Economic Theory), Cairo, 1960 (in Arabic). Full references to the Prophet's *aḥ®dith* (traditions) cited in this paper are given in that book. Mr. Pickthall's, *The Meaning of the Glorious Koran* was used for the English translation of most verses cited.

1.1 The Major Policies of the Prophet (s.a.w) and the Basic Economic Characteristics of His Time

To understand the policies initiated by the Prophet (s.a.w) in al-Mad¬nah, we must understand what was the basic characteristics of the economy at that time. This will enable us to understand these policies and their significance in achieving the goal to actualize, as much as possible, the Islamic economic philosophy.

Historical research on the era of the Prophet (s.a.w) shows that the main characteristics of the economy of al-Mad¬nah were as follows:

a. it was an agricultural economy, where the products were mainly for individual use and they were produced on a small scale basis.
b. there was a high degree of commitment and self-sacrifice shown.

As we know, the Muslim society at the time of the Prophet (s.a.w) consisted of al-Anṣ®r, the ᶜAws, the Khazraj tribes, the Muslims, and the *Muh®jir¬n* (who were the emigrants from Makkah). The majority of the Anṣ®r were farmers who cultivated their land using simple tools. The *Muh®jir¬n* were mostly the traders. They imported commodities on caravans to al-Mad¬nah. During those times and in such an economy, there were no big industries and no mass production. Production at that time was labour-intensive. Simple tools and facilities were used especially for the purpose of irrigation. The important fact is that humanity did not yet develop the concept and capabilities of mass production.

The other important feature, which has a great influence on the economy is the attitude of the people. Their desire for solidarity, willingness to self-sacrifice and their faith in *tawḥ¬d* play an important part in the economic success of the society.

With these few facts in mind, we can understand the policies and the means applied by the Prophet (s.a.w). These are:

a. Sense of commitment and self-sacrifice
b. Rent-free land
c. Interest-free money and capital
d. Shareholding

e. Well-managed and behaved market
f. Redistribution of wealth and resources
g. *al-Zak®h*

a. Sense of Commitment and Self-Sacrifice

Since the Islamic philosophy and the Prophet's commitment were one of justice, brotherhood, love, cooperation, and self-sacrifice in the constructive sense, this attitude was of great help for the Prophet (s.a.w) to develop effective policies to apply the Islamic goals and philosophy without resorting to force. With this fair and charitable spirit, it was hard to find a man, a woman or a child left in need, or a neighbour not taken care of. We should not belittle this feature of that society since it is the human initiative, which is the real factor behind all kinds of progressive developments, including economics. One's sense of justice and brotherhood seemed to be the missing ingredient for achieving real and lasting progress of what is nowadays called the underdeveloped countries. Without changing attitude, neither economic nor foreign technological aid will help solve the problems of these societies.

In the society of al-Mad¬nah, the teaching of *tawḥ¬d* and the sense of brotherhood means no call for help is refused. All the members of the society, therefore, work to serve and provide for themselves and their society.

b. Rent-free Land

We have, in Part I of the article, cited the relevant *aḥ®d¬th* concerning the prohibition of renting land, and discussed the concept behind it. In applying the policies, it means that the owner of a plain land can cultivate it, and whatever which is left uncultivated can be used by another man free of charge. Rent can only be charged on the land where the owner invested labour and money to develop the land. The owner can rent out the land to compensate for his labour, money, and services. However, the limited capacity of man in utilizing financial and technical resources at that time has, thus, limited the income disparity between the high income and the low income groups.

c. Interest-free Money and Capital (Loans)

The third policy that the Prophet (s.a.w) implemented was to inhibit the members of the Muslim societies from charging interest on loans. At the same time, the limited capacities for use of financial and technological resources made the need for loans limited. Most people could save the necessary amount of money they needed for their work. When the need for additional amount of money arises, people can get interest-free loans. This means that in the pursuit of justice, the natural productive potentials of land and money were made available free of charge to all members of the society. In that society, human labour is the major source of individual income and wealth. Interest-free loans were, hence, encouraged, and were guaranteed by the State. All possible means and procedures were implemented to ensure repayment of loans. This arrangement did justice to both the lender and the borrower.

d. Shareholding

In shareholding, one offers capital and another offers labour. In that society, it was meant primarily to make sure that a Muslim brother could get the financial resources he needs to do his work or run his business. It was not meant to open a side-door for exploitation and false private claims of *rub,biyyah* through excessive and unfair share of capital contribution and the risk associated with shareholding.

In such a society, money and capital were used on a limited scale and on an individual basis. With the spirit of brotherhood and strong solidarity between the members of the society, shareholding was a just and practical means and a good policy. Practically, there was no place for exploitation and no widespread *rib®*. There was a close supervision from the government to ensure fair practice.

Shareholding, we must realize fully, at that time was meant to help a fellow brother to work. It was also meant to help the weaker members of the society, such as women and orphans. The idea was to distribute a fair share of the benefits especially from trade for the purpose of living. Shareholding and partnership between the workers and the owner of capital was one good way of providing the necessary capital for a fellow worker who cannot guarantee that he could pay back the money, or cannot take the risk of borrowing on his own. Sharing of profits gave the owner the opportunity to watch his capital grow. It also ensures that in the long-run, his capital is not lost. As a matter of fact, if we look closely, we will find that shareholding at that time was done with the spirit of solidarity and, at the same time, it provided some kind of assurance. It was never meant to be a means of exploiting and controlling production.

e. Well-Managed and Behaved Market

The fifth policy of the Prophet (s.a.w) was to develop a well-managed and well-behaved market. The *Sunnah* is full of rules and regulations to help maintain a just and well-behaved market. The Prophet (s.a.w) made sure that no monopoly was practised in the market and that the market is fair and free of cheating. He prohibited speculation and all kinds of ill deals. In summary, the market was for the purpose of trade and not for *rib®*, monopoly, and speculation.

f. Redistribution of Wealth and Resources

To develop a sense of equality and brotherhood, the Prophet (s.a.w) resorted to redistribution of wealth and land between al-Ansạ®r and *al-Muh®jir¬n.* It was done through mutual consultation and consent. The redistribution was not meant to impose injustice to one group or the other. It was meant to keep a sense of equality and justice. The *Muh®jir¬n* were welcomed as full members of the society. They were not left to charity alone but given proper opportunity to work and provide for themselves and their families. Since the spirit is justice, brotherhood, and cooperation, the Prophet (s.a.w) did all that he could to return the original land to its previous owners, and whenever he could provide the user with an alternative land or source of living, he did.

This reflects the real meaning of public and private property and ownership in Islam. It shows how a member of society can have the right to use natural resources. When a man prepares and develops a natural resource for production, he should be given the priority to use it. That was why the properties were returned to the original owners who were the Anṣ®r. The way the Prophet (s.a.w) put that important policy in practice, peacefully and in a brotherly manner, is a great lesson to policy-makers of the Muslim countries today. This policy encourages all able members of the society to work and produce.

The Prophet's redistribution policy was one of the major concerns of all members of society, i.e., a policy of *tawḥ¬d* and brotherhood. It was not a policy of conflict and hostility because Islam favours no one class or race. There is no class, race, or national barrier in an Islamic society. The *Qur'®n* and *ºad¬th* state this principle very clearly. In the *aḥ®d¬th* cited earlier, we saw the Prophet (s.a.w) endorsing, in case of emergencies, the far-reaching policies of redistribution which were practiced by *al-Ash®cirah.*

g. *al-Zak®h*

al-Zak®h is one important way of ensuring justice and brotherhood. It is one of the five pillars of Islam. As mentioned earlier, a fully just and accurate separation of what is due to labour or to natural endowment including capital used in any production process is very difficult, if not impossible.

According to the Islamic spiritual philosophy, in a society, a sense of justice and self-sacrifice should prevail. The haves should make sure that their income touches nothing which belongs to the weak and the destitute. *Zak®h*, in this sense, is a duty of the haves and the well-to-do towards the needy, destitute, and weaker members of society.

1.2 The Economic Characteristics of Contemporary Society

How can we in the contemporary world apply again the same Islamic goals and philosophy? What policies and means should we seek to bring that philosophy into practice again? It is not only important to present a philosophy, but it is equally important to explore the ways and means to apply and put this philosophy into practice. To be able to explore such issues and concerns, we need to examine the contemporary world. We have to understand the shift, if any, in the major economic characteristics of the contemporary world in comparison to the time of the Prophet (s.a.w).

In the light of a proper picture of the economic situation of our world, we can explore the question of policies, and ways and means to reapply the Islamic philosophy. For the purpose of this paper, the major economic characteristics are divided into the introduction of mass production, the division of labour, and the widespread use of technology.

Before we can answer this second big question, we should clarify the economic changes that have taken place in contemporary society which make it different from those at the time of the Prophet. Only in this way can we start on a realistic and scientific basis to suggest the policies needed now. We will try to discuss the major changes as follows:

a. Mass Production and Division of Labour

Mass production and division of labour, no doubt, represent the main characteristics of our contemporary world. The widespread technology has given capital and machines much more prominence as well as massive use in the process of production. This, in turn has great impact on the size of individual income, one's capacity to produce, and the distribution of wealth in the society.

Capital use is no more on individual basis and the amount used is no more limited in quantity or simple in quality. Most factories and industries are great concentrations of capital, and the work force has to cooperate and work in groups to make good use of capital. Production is no more an individual task but it becomes a teamwork. The production and prices of the produced goods are to be distributed between the members of the teams. It is evident that the process of production and distribution are getting more and more difficult.

b. Technology

As a matter of fact, mass production and capital-intensive industry are the result of the technological revolution. The use of machinery and electricity has changed radically the process of production.

The major change which I would like to emphasize, is in the technological and scientific research. Technology has opened the door to a more productive and complicated economic life. At the same time, it has increased man's capacity to solve problems and to bring more sophisticated, accurate, and effective means of answering man's needs. It also helps in drawing more effective policies and better economic plans. Technological development is an ongoing process. Considering the growing population of the world and the need for more efficient services and better products, we should welcome and encourage the growth and positive application of technology. But in the Muslim society, we should be alerted to the possibilities of *rib*® and injustice with the more intensive use of capital and technology. We have to draw all the necessary policies to prevent such harmful practices.

One major concern of Muslim policy-makers is that a decreasing number of people can use "begging and beggar capital technology." How then can we consider the individual rights and shares in the endowment and proceeds from production? For the underdeveloped countries, they too have to worry about saving some of these proceeds fairly, justly, and effectively to build-up their capital and infrastructure.

1.3 Modern Means and Techniques

To achieve the goals of Islamic philosophy of *tawh¬d, khil®fah,* and brotherhood, which is free from *rib®,* we should, as a starting point, study the already existing economic ways and means which are available to policy-makers. In order to develop a better and more effective means of combating the problems, we should see how we can employ the Islamic philosophy in the contemporary society. We should start looking at every system and institution to find a function it could serve.

This may dictate some necessary modifications in the structures of these systems and institutions. Or we may find it necessary to have some of these systems or institutions getting together to serve the Islamic goals.

Let us examine some of these present systems which may serve the Islamic economy:

a. The Banking System

The banking system of the contemporary societies serves many important functions in the collection, investment, and channelling of capital to meet the needs of business and industry.

Bank interest in a capitalistic society is a by-product of a certain definition of ownership combined with scarcity of capital. In the Islamic society, we need a similar institution to collect savings and channel the necessary capital for the business industry. This system should be free of *rib®*. The *ummah* should be educated and persuaded to save and seek no direct income from these savings. The government, in return, should come up with arrangements to secure these investments without putting a burden on the society.

b. Insurance

Insurance is another useful contemporary economic institution in the financial system. Insurance companies, like banks, collect and attract savings and serve to reduce the risk of business and industrial operations. This, in fact, is very much similar to the old concept of Islamic shareholding in the Muslim society where owners of the money do not aim at exploiting the workers. Instead it helps the weaker members of the society to get a fair share of the profit. We shall see that with the help of a banking system, an insurance system, and the technology, a Muslim contemporary society can find a proper way to raise large amounts of capital and to finance industry in a better and more efficient manner without sacrificing the concept of Islamic economic brotherhood.

These and other systems can serve the Islamic policies. They are to be used and developed with the help of ever-developing technological means. These systems can reduce the reliance on manpower and make services faster and efficient than ever before.

Technology and scientific research not only help in the growth of production but also in the process of distribution. It enables mankind to produce statistics and accounts available in all desired forms, and in no time.

Without the increasing and efficient use of technology, especially computers, it is not feasible to compute complicated national statistics and accounts. With the help of this technology, it is possible in the contemporary world to compute the national income and the due shares of the factors involved in the production process.

c. Taxation

Modern techniques and computing are necessary in the contemporary society to ensure a more effective taxation system. Taxation serves two purposes: one is to collect a just share of the income of members of the society, and the other is to readjust their income to eliminate *rib*®. Effective tax collection should help the readjustment of the income of members of the society in such a way that it only collects what rightly belongs to others. This serves to eliminate *rib*®. The proceeds of an income tax could be used directly or indirectly to ensure that the weak and destitute get their fair share of the resources. Progressive taxation could be used as a technique whenever it is difficult to sort out the rights of other members of the society, especially the poorer and weaker members. The other side of taxation is subsidies and indirect help to the weaker and poorer members of the society. People and governments should provide the needy members of the society with whatever they can afford.

d. Nationalization

Nationalization in its different forms, is used to direct social change, redress social injustices and maintain public interest. Nationalization, according to the Islamic philosophy of justice and brotherhood, should not be used to harm people and deprive them of their lawful property. If the Muslim society needs to nationalize any kind of individual property for public use or services, the society should protect whatever the person had invested in that property or the means of production. This protection of the individual investments and labour should equally be applied if the property was nationalized for public service or for the purpose of providing for the needs of some members of the society.

2. Suggestions on Methods and Policies

At this point, it would be appropriate to propose some tentative policies in the form of an outline in order to see the feasibility of an Islamic economy by applying, adopting, and developing contemporary means and methods. These proposed policies are, to develop:

a. Islamic systems of education and mass media.
b. an advanced and competent social system and public administration.
c. an Islamic guarantee of savings and productive capital.

a. Islamic Systems of Education and Mass Media

The first two policies look simple and clear. But unfortunately, they are not. In the present day context, it may be proper to touch briefly on these two aspects. It is imperative that we reform the Muslim mind to remedy the mistakes we made in educating and upbringing our children. Education should produce children who are inquisitive and have love for knowledge. They should also be physically free and morally strong. Their mind should be free of superstitions. We have to raise a person who is a good individual and a good member of the *ummah* — a *khal¬fah* who is at peace with himself and in love with Allah and who understands his mission in this life and his eternal fate.

All these characteristics are readily part of Islam. However, to achieve this we have to reform the Muslim mind. It is only through an intellectually reformed mind that the Muslims can control the mass media.

b. Advanced and Competent Social System and Public Administration

The second aspect of these proposed policies relates to the lack of good public and social administration. The best of the young minds are usually encouraged to do Physical Sciences whilst the weaker ones do Human Sciences. Professional fields of work in our backward culture are not a matter of intellectual interest but are rather a narrow choice of physical means of living. This, in turn, would affect the quality of workers employed in the administrative sector as most of them would come from the Human Sciences background. In upbringing and educating our children, we should instill in them a sense of *khil®fah* mission. We should aim at producing Islamic social and human scientists who are intelligent, creative and innovative. These quality workers are necessary to build a dynamic, creative, and capable public social system and administration. Good and capable public social system and administration would, in turn, produce capable physical scientists.

With poor social system and public administration, even the good scientists may leave and migrate. Good administration will provide the necessary means and conditions to create and attract good physical scientists. Our young generation should have pride in whatever field of work and knowledge they choose. Our societies should strike a good balance between educating students of Human Sciences and educating students of Physical Sciences. This is a basic aspect which is necessary to reform and rebuild the Muslim societies.

c. Islamic Guarantee of Savings and Productive Capital

The third policy, in many ways, is new and distinctly Islamic. It, therefore, needs some explanation and elaboration. This policy aims at encouraging, motivating and protecting savings. To understand this policy proposal, we need to recall some concepts already explained concerning the nature of distribution of wealth in a modern Islamic society.

We have already explained that in a fair Islamic society, normally the differences in income could not vary greatly between human beings. These differences are limited by the differences of the nature of human capacity for work and thinking. They are not to be decided by individual claims on any kind of natural resources. Income which is related to the natural resources is a collective national wealth. Its fruits, in principle, should be divided equally among all members of the society. Private ownership here is only a functional mean. It provides only the priority of use and not the right of total and absolute ownership.

To be able to follow this argument, we need the actual dominant contemporary practice in our society, be it liberal capitalist or totalitarian socialist. The Muslim social and economic system is philosophically and conceptually distinct and different. Muslim societies, like all other societies, need to raise capital to build their means of production. The financial resources for mass production cannot be raised individually. Individual incomes and savings in Muslim societies is limited by human capacity for work. The nature of individual income and wealth makes it necessary for Muslim societies to provide a proper and fair method of creating a capital pooling system to finance big industries.

Economically speaking, in a Muslim society, productive members who are not practicing any kind of exploitation, should have the desire, interest, and ability to create a proper system for the purpose of raising the capital needed for big and advanced industries. Such a system will make it possible for all of the productive people to work and get bigger portions of the proceeds. It is bigger because their share is made up of two parts. The first one is their equal share of natural resources and the second and additional one is the income from their work. Clearly, the second part depends on the efforts of each individual and his or her personal capacity.

We should keep in mind that the more capital and natural resources the society uses the bigger the share of income the individuals get. Members of society can see that the bigger the available capital, and the more serious and sophisticated their work is, the bigger is the income of each individual. The increase in income would provide a strong material motivation for more savings and more serious and sophisticated work.

Creating a successful capital saving system is one great challenge which contemporary Muslim societies are facing. To achieve this purpose, especially in countries where capital is scarce, governments and public administrations, and agencies, in a variety of ways should encourage and facilitate individuals and members of society to save a good portion of their income. The idea of pooling is to make capital available to industries in the first place. The important thing is not who is going to use these savings but the individual's right of ownership should always be secured. A person could consume his savings if he needs or prefers to use the capital. Individual uses would not take away their tools and means of living. The values of these tools are to be considered as loans. If the individual needs more to face his or her needs, other charitable resources, such as, *zak®h* should be considered. The person should not lose both the savings and the tools at the same time. In all cases, members of society will benefit from the fact that their savings are put to work and not kept idle. This will increase the output of the natural resources and will in turn improve the average share of every member of the society. Government and public agencies could also use foreign aid and loans for the same purpose. Government corporations and companies could pay to the foreign owners the just, proper, and fixed price for the use of these resources, otherwise, other societies are not going to benefit from the use of these resources, be it land or capital. A fair price has to be fixed for the use of foreign resources or else there would not be much mobility of resources and capital across international boundaries.

In a contemporary Muslim society with big industries, insuring the national capital seems to be one good answer. It is possible to provide one proper and necessary method. This job is the function of a government and its agencies. Many parts of this job are already practiced by government institutions. These agencies usually supervise and provide public statistics, keep national accounts and collect taxes. National capital insurance is, in many ways, broadening and extending these governmental jobs and functions which basically involves the keeping of accounts, producing statistics, and collecting and distributing taxes.

Banks, on the other hand, which are regulated and to a certain extent guaranteed and protected by governments, pool savings, protect them and collect the benefits assigned to them. At this point, we need to be more precise and clear in the meaning of guarantee and insurance of the national capital as well as the goals it is supposed to achieve.

National capital insurance is basically the job of a government and its agencies. It includes keeping track of all kinds of savings, capital, and productive assets. These accounts and statistics will help nations and countries to monitor and increase savings and build up the necessary capital for national industries and services. It helps the Muslim governments to evaluate and collect all kinds of taxes more accurately and fairly. In addition to this, it helps the Muslim government and *ummatic* (national) rights in the profits of using the natural resources. This, from an Islamic perspective, in many ways is a sort of wider use of the concept of *khar®j. Khar®j* is a collection of part of income from land due to its natural capacity or collection of rent of national land under the control of the government. In *khar®j*, the government represented the society when it gave lands for farming to individual farmers to cultivate.

Under the concept of national capital insurance, every person who owns any amount of capital or assets will be insured. Whenever a person needs to use his savings, he can get it even if he himself or any other person is using them as a tool for production. The person using the capital in this case will be the borrower. He will be held responsible for the safety of the assets and the collateral. The proper insurance and public agencies will charge and deduct a certain percentage of the profits received to cover for possible losses. This concept of insuring and encouraging savings and loan offering is not strange to Islam. The Prophet (s.a.w) issued a similar policy. This is mentioned by al-Bukh®r¬, Muslim and Ab, Daw,d:

> "Any *mu'min* (Muslim) who died and left property, it goes to his lawful relatives wherever they are. And whoever (died) and left unprovided for debt or other financial obligations, the concerned party should come to me (to pay the dues). I am responsible for such a person (*mawlah*)."

With this kind of arrangement, the worker will keep the necessary tools and capital, otherwise he faces a possibility of losing his savings as well as his job. The situation will be similar to a case where a person uses his savings or assets. Under this system, he gets the value of his money or assets at the point of surrendering them to the concerned public insurance agency. In many ways, these agencies will do the combined jobs of a bank, a mutual insurance company, and a national planning board. They pool savings, provide capital, collect *khar®j* (benefits of using natural resources) and distribute the due shares to every member of the society.

From the above suggestion, this national capital insurance policy is meant to increase the mobility of savings, capital, and assets and make them available to the concerned industries. The insurance policy can provide a proper and flexible channel to help, supervise, and maintain the national wealth and the public interest, especially that of the poor. This will make it more difficult for any *saf¬h* (a person who is incapable of preserving his wealth and interest, and who also cannot make reasonable judgement) jeopardize his interest and the interest of other people.

This policy will create more consciousness in the public to protect the national wealth and secure the public interests. It should also help in fighting corruption and wastefulness. In this system, like many other systems, the responsibility of managing mass production and big business companies is in the hands of the competent and motivated shareholders and professional managers who can safeguard and manage these industries very well. They would otherwise stand to be the first losers because the insured capital and assets are to be secured first besides other legal punishments.

Undoubtedly, such a suggestion needs a lot of study and thought before it can achieve its *khul®fah* goals. It is clear that many economic issues should be reconsidered carefully to suit these goals and policies. Inflation is one major issue to be studied and resolved. A change in the real value of money would affect the real value of savings of the people. The obvious solution to protect savers is either by eliminating inflation and stabilizing prices or by compensating the savers on a regular basis for the losses that had been incurred because of inflation.

To make the system work successfully, competition and alternatives are very important aspects for any successful economic system. Bureaucracy and lack of competition and alternatives, will usually end in negligence, wastefulness, monopoly, and rigid policies and operations.

The bottom-line of this insurance proposal of the national capital is to administer economic justice and eliminate *rib®* (economic injustice). Muslim governments should help in more organized economies which are justice-oriented to encourage and motivate individuals to work hard and at the same time safeguard the public and *ummatic* interests. The field to offer a workable system and policies is wide open. All we need is to uphold the goals of the Islamic economic justice.

3. Back to the Basics: On the Equal Sharing of Natural Resources

Coming closer to the end of this work, it is necessary to shed some more light and explain some basic concepts which form the nucleus of this work. These concepts are about the equal rights of all members of society in the ownership of the natural endowments and resources and the fair sharing of its proceeds.

For the purpose of explanation and clarification, let us assume that the society is composed of only two members — A and B, with natural resources of 100 acres of land. If they acknowledged that the land was created by Allah (s.w.t) for their use, that both of them are members of the same society, that both were created by Allah (s.w.t) and neither of them related Allah (s.w.t) in a different way, each will get 50 acres for his use.

For the society to function, both of them should respect the interest of the other. The decisions of each member will affect the interest of the other and, in this case, the total production of the land in this society. No member of the society has the right to take action, which might harm the resources in his possession, or those possessed by other members of the society. The position of each one of them is the position of *khal¬fah* (vicegerent). Property, thus, has the aspect of being private and public simultaneously.

On the other hand, the ability to work varies from one person to another. Allah (s.w.t) created humans with different abilities, some are stronger or more intelligent than others; some are rendered less capable for reasons such as age or birth defects, etc. Let us assume that an individual, B, in our example, can cultivate only 30 acres, while A is capable of cultivating the extra 20 along with his share of 50 acres. Their labour and decision will affect the quantity and quality of the total production of their land and society.

In this case, how should the income distribution of the land be decided? If A were to keep the income of all 70 acres and gave nothing to B, the latter would have no incentive to make his 20 acres available to A. If the 20 acres were kept uncultivated, neither A nor B would gain, and this entails misuse of resources contrary to the reason of creation. The only just distribution is to divide the income of the twenty acres between A and B, giving the stronger the reward for his work and the weaker his share of the land's natural capacity. Here we see that both members of the society have an equal (50%) share of income even though one has 70% capacity for work while the other only 30% capacity for work. In this way, both are better off. Thus, the process of production and distribution is done in a just and cooperative manner.

Ownership of factors of production is meant, from a purely economic point of view, to bring continuity and stability of production to human societies. This means that ownership in Muslim and *khil®fah* societies is not absolute but it gives priority of use to the capable and the more industrious members of the society in order to benefit all members of society, both strong and weak.

This basic difference in the definition and concept of ownership is very important to guide Muslim economists in their search for developing original, systematic, and comprehensively functional system of Islamic Economics.

Muslims accept and believe in the concepts of *tawh̤¬d* and *khil®fah* (which implies equality) and in the concept of brotherhood (which implies cooperation). Islam makes these basic concepts as the foundation of human society. All human institutions including that of private ownership should reflect these concepts. Inclusive private ownership is a capitalistic concept. This capitalist concept of private ownership is not in a fundamental way, incompatible with the Islamic values of equality and cooperation.

A strict equality in the ownership of natural resources would require very frequent redistribution of these resources among members of society. This would be disruptive to economic activity and growth. The Islamic concept of economic equality should, for practical reasons, work as a guideline to provide the weak and the disabled members of society with their needs with dignity. It is only the Islamic concept of ownership that is capable of realizing the concepts of justice and equality.

Muslim economists have to continuously develop the means for economic production and social stability in order to provide the weaker members of the society with their rights and needs. The stronger and more favoured members of society should be taxed in appropriate proportion to their actual use of the national resources of society. Taxation, in the foreseeable future, seems to be the best method for preserving the economic rights of the weak.

Governments and societies, with the help of all kinds of modern techniques, should make sure that every member of the society, regardless of the quantity or quality of resources, gets his fair share in the natural endowment and resources of the society. Allah (s.w.t) gives these powers and resources to the whole society. Allah (s.w.t) says:

> ". . . and bestow upon them of the wealth of Allah which He hath bestowed upon you." (*Qur'®n* 24:33)

> "And in the (believers') wealth there is a right acknowledged for the beggar and the destitute." (*Qur'®n* 70:24-25)

It is also important to mention here that the main purpose of distribution is to achieve justice, maximum efficiency, improvement in the living standards with maximum efficiency, improvement in the living standard of the poor, and encouragement of innovation and creativity in the fields of business, sciences and technology.

Societies and governments should do their best to maintain a stable, dynamic, and viable economy. They should, at these times, maintain and encourage a well-disciplined Islamic free market according to their well-informed free will.

An Islamic free market is well-informed and free of all kinds of monopoly, corruption, trickery and speculative deals and activities. The Islamic free market neither creates nor takes excessive advantages or shortages from natural disasters. Information and training would help correct the market trends and mobilize its resources in the right direction at the proper time.

Science and technology should be encouraged to help the people. This knowledge is also important in developing the country. Scientific and technological institutions and companies should not exploit people. A system of reasonable return should be devised to protect people from the monopoly of technology. Exaggerated intellectual rights are examples of new forms of monopoly and imperialism.

Muslims and Muslim economists and leaders should advocate the sense of justice. They should help in combating exploitation of the poor nations by the more advanced countries. This is usually done by monopolizing high technology. They use this technology to control, exploit, and cripple the poor nations. Underdeveloped nations should make it a priority to develop the necessary conditions to create and enhance their people's abilities in the fields of science and technology. Every section of life and people's interest should be articulated and fairly protected to ensure justice for all.

4. Conclusion

At this point we have come to the end of this work, and I hope I have clarified some of the basic concepts of the Islamic philosophy in economics. The general argument of this paper is to conceptualize the basic philosophy of Islam in economics while the macro aspects still require a lot of work. Combating macro aspects of a capitalist economy is futile and useless. Without clear basic concepts, philosophy, and macro comprehension in judging micro details, it could, if not handled carefully, become counterproductive.

One of the problems facing the Islamic economists is that they are used to the capitalist system with no help from an operable Islamic economic system in real life. Theoretically, conceptualization is one difficult stage which demands hard work and patience.

5. Additional Remarks

This paper deals with the issue of the philosophy of Islamic Economics, and more importantly, it was an application of a new professionally Islamic and methodological way of thinking.

It is important at this point to reflect briefly on the methodology used in this paper. The methodology in this paper represents a clear departure from the old partial *Uṣ,l al-Fiqh* methodology, which is usually used in the field of Islamic studies. This methodology is more of the methodology of social science. It is a comprehensive, analytical, and systematic way to review the *Qur'®n* and *Sunnah* as the sources of Islamic revealed knowledge, vision, concepts, principles, and values. In this regard, these concepts are basically *tawḥ¬d*, *khul®fah*, justice, and cooperation.

The second part of this paper is devoted to the study of the policies implied in the *Sunnah* of the Prophet (s.a.w) in light of the *Qur'®nic* vision, principles, and goals. To use holistic methodology is necessary if we want to benefit from the policies of the Prophet (s.a.w) in order to address the ever-changing capabilities, needs, problems, and conditions of human societies and peoples in time and space. These policies, no doubt, will shed light on the ways and methods used by the Prophet (s.a.w) and the Muslims in the past to attain the Islamic goals.

To attain *ijtih®d* in today's world, we should clearly understand that *qiy®s* (analogy) and *istiḥs®n* (referral to the spirit of the *Shar¬ᶜah* whenever *qiy®s* fails) are suitable to work basically with, and explain partial and limited cases of changes in societies. After fourteen centuries and major changes that took place in the nature of human ways, means and lifestyle, there is a need for a holistic, comprehensive, analytical and systematic methodological approach to understand and benefit from the historical Islamic texts and legacy and bring them to relate to the conditions and way of life of our contemporary world. The guiding principles and methods of our contemporary Islamic methodology should be relevant and dynamic to be able to generate the quality of thought that is able to allow Muslims to lead in the contemporary world.

This study, through the above-mentioned methodology, tries to understand the nataure of the early period of Islam and the way it established the Islamic ways of life. The study also tries comprehensively to understand the meaning of the basic changes in the contemporary economic world from the old economic world. The old economic world was a nomadic and agricultural world while the contemporary economic world is of an industrial and mass production nature. This conceptual methodology is an essential tool for a contemporary Islamic thinker to develop a viable and dynamic system of Islamic economics.

In light of the universal vision of Islam and its values and concerns, the paper tries to develop relevance of the Muslim heritage to the contemporary world. It tries to study and examine the texts of the *Sunnah* as part of the historical Muslim agenda, and economic policies to find out which ones of these policies are still applicable, which ones need modification, and which ones are historical and are no longer applicable. The introduction of this paper elaborates and sheds more light on these aspects of the *Sunnah*. It provides many direct examples of the Prophet's (s.a.w) policies in response to the needs of his people in time and space. It is found that one of the most urgent needs at that time was the introduction of a full monetary economy. The paper shows how cleverly the Prophet (s.a.w) has tried to provide the necessary amount of currency the society needed from gold and silver. By simply declaring gold and silver as money and should no longer be used as a commodity, gold and silver became the major monetary means acceptable during his time.

Finally, this paper has attempted through the above methodology to see in which way the Islamic social and economic justice could be achieved in our contemporary world and societies. It was clear that the State should not interfere in the life and the economic activities of individuals beyond what is necessary to maintain the basic values and stability of the public interest and order. In this way, individuals' initiative and creativity would not be hindered.

At the same time, while the individuals are to enjoy the fruits of their work and effort, they should not deny unjustly the rights of the weak and the disabled (*al-mahr,m*); their lawful rights as equal members of the society. It was clear that this should be done through the taxation system. This has been done before in the case of *al-khar®j*. It was collected by the Muslim treasury for the general interest and needs of the Muslim society at large, and the weak and disabled Muslim members of the society, in particular. Using the taxation system to ensure that the public rights and needs are met allows social justice to prevail without interfering with the individuals' freedom of work and initiative.

In general, there are a few lessons that need to be highlighted:

a. Islamic revelation is basically the source of holistic Islamic vision and knowledge. Its basic role is to provide guidance, direction, goals and values for a meaningful, integrated, and good human life, in this world and the Hereafter.

b. The *Qur'®n* and *Sunnah* are basically not of the same level or duplication of each other. Nor are they meant to serve the same purpose. Each of them has its own role. The *Qur'®n* is basically the main source of the Islamic vision, principles, and values. The *Sunnah* basically draws policies, offers applications, clarifications and explanations of the Islamic vision, and values. These applications provided by the *Sunnah* present historical examples of how Islamic goals could actually and successfully be applied through the ages according to the needs of the peoples in time and space.

c. Knowledge of the nature of all things, and knowledge of the conditions of peoples and their circumstances, are the other source of human knowledge. It is through human scientific knowledge that the Islamic vision, values and concerns could become a reality in an operational system, and a dynamic and successful way of life.

d. Without revelation, man would be devoid of holistic total meaning and direction in this life. Without human scientific knowledge, revealed knowledge will just be philosophical theories and rhetoric, and in many instances would be misunderstood and misinterpreted. Human scientific knowledge is the necessary vehicle which carries revealed knowledge to become a fruitful reality.
e. Muslims need both revealed knowledge and human knowledge (sciences). Revealed knowledge is to provide a holistic and global direction. Human knowledge using scientific methods in its wider sense would provide the means for man to attain real, healthy, universal, and holistic vision. These methods should be comprehensive, analytical, and systematic. The detailed methods would vary from one field of knowledge to another.
f. Time and space is a vital concern in understanding nature, capabilities, state of mind, and needs of human beings, individuals and societies. For this reason, it is important for Muslim peoples and scholars to approach the application of the *Sunnah* comprehensively, with full awareness of time and space factors inherited in it as policies and applications. To achieve this successfully, they should be equipped with the best possible human knowledge available. In this way they can understand best the Islamic vision and goals in the light of contemporary human capabilities, concerns, and expectations. With these instruments, a workable Muslim social system can achieve partnership and an advance place in the civilization of human race.

Some of the major and fundamental ideas and conclusions in the area of methodology could be summarized as follows:

a. Islam addresses the real nature of man. Studying the nature of man and his world is essential for understanding the true meaning of the Islamic guidance and direction of the Islamic revelation. Ignoring the study of time and space factor is damaging and it would prevent the proper understanding and application of Islamic economics.

b. *Khil®fah* (vicegerency of man on earth) is the basic concept behind the structure of justice in the Islamic economic system and way of life.
c. Human nature, in light of the concept of Islamic *khil®fah* would encourage and help develop men as members of society and keep a balance between individual and societal interests. Islam encourages members of the society to pursue their interests. An individual member of the society should be the first one to reap the fruits of his work. Whatever man produces through his work and efforts, it belongs to both the worker and members of the society. Compassion would be that an individual member of the society gave to the needy and the disabled, part of his earning for use by all members of the society.
d. All members of society, weak or strong, are equal partners in all the resources and endowments Allah (s.w.t) has created for them in this world. All of them should get their fair share of the fruits of these resources.

It is important, at this confusing point of time that Muslims realize that human civilization is in crisis and in need of better vision and safer direction. Muslims and Muslim economists should liberate their mind and move beyond detailed and petty issues related to the capitalist economic system. They should move beyond the legalities of Islamic banks. They should regain their holistic vision and resume their intellectual research and discussion using proper Islamic and scientific methodology to build the Islamic economic goals, philosophy, system, and the effective practical means to build them.

Muslims should not lose their Islamically balanced approach to life. Humans are individuals. They are one in origin and species, but are created male and female, in different colours, speak different languages, and have diverse cultures.

We have to fully understand and fully comprehend that the Muslim economy is neither totalitarian nor *laissez-faire*. Muslims should not follow blindly the global capitalistic policies as many of these policies represent capitalist and foreign interests. Muslims, like anybody else, need to be concerned first with their own conditions and interests. Their reform should address the real intellectual and cultural reasons for their ills. At the same time, they should not lose. Intellectually and culturally well-reformed, and spiritually and morally inspired Muslim thought, can always provide the *ummah* with the best way to overcome the challenges the *ummah* and humanity faces. Actual, well-reformed Muslim social system and civilization not only could help and benefit the Muslims but can also provide the contemporary world with a well-guided, constructive direction.

Islam is the religion and global vision of *tawḥ¬d, khil®fah, ᶜumran,* integration, harmony, peace, justice, balance and moderation, and compassion. All that Muslims need is a true, courageous, intellectual, methodological, and cultural reform, enabling them to emancipate themselves from a slave mentality and blind imitation and adopt the right Islamic educational approaches and policies to develop new generations of Muslims with courageous and responsible attitudes as well as a scientific mentality.

As a final word, the author appreciates any discussion, observation, and critical evaluation of this paper and the personal point of view expressed in it, since discussions and constructive, critical evaluation is one major way to develop new good ideas.

Note

In Part I of this article, the *ḥad¬th* which supports the argument on insured loans through mutual insurance or government guarantee or through shareholding (p. 107) is as follows:

> Al-Bukh®r¬ and Muslim reported that Ab, Hurayrah (r.a) said that the Prophet (s.a.w) said: “Whoever leaves behind a property, this property goes to his *war®thah* (next of kin) and whoever leaves behind debt, myself and Allah (government) would pay (the debt).”