**Alternative Economic System**

By

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AUTHOR’S PREFACE

Economics is concerned with prosperity as the material aim that contributes to the nonmaterial ultimate objective of welfare. In figures, national product expresses prosperity and its rate of growth reflects the rise in the standard of living. Realization of prosperity requires that the maximum and best utilization of available resources should be considered as the ultimate objective of any sound economic system. The system should care about the fair distribution of wealth among people.

In present economic systems, most of available resources are directed toward financial and speculative activities in local and international financial markets. Present systems are designed to help concentration of wealth in few hands. Monetary controls failed to prevent the destructive impacts of financial and speculative activities. Through increasing national debt, governments are injecting trillions of dollars into financial systems for economic recovery. The poor and the middle class have to pay the bill for such monetary policies, while the rich are becoming wealthier.

Instead of reviewing the foundation on which the present economic systems are based, economists in power are directed to handle economic problems. Present economic systems are based on some fallacies that, by the lapse of time, have been accepted as if they represent a part of the natural life which people have to live with.

1. Viewing money as the heart of economy.

Money was introduced to facilitate transaction of exchange products. Nowadays, the role of money is broadened out of its scope. Money becomes profit generator and its quantity controls economic activities.

1. Viewing financial activities as economic activities.

Economic activities have its origin in the wants of a community. Its main purpose is the satisfaction of those wants. Production is meant the activities which result in the creation of utilities. Instead of investing in productive activities, huge amount of resources are directed toward financial activities.

1. Believing in the tradition of the currency backing.

To avoid producing money in precious metals, currency backing was introduced to give value to the currency as a replacement for the real commodity. Money is no longer a real product or a substitute of a product. It is just a social invention used as a measure of value of products. There is no logic behind retaining currency reserve for issued money. In present economies, credit money represents most of the money in circulation.

1. Viewing inflation as natural phenomenon.

Present economic systems are designed to produce inflation. Inflation arises, mainly, because of the additional costs which do not represent a direct cost of factors of production.

1. Believing that free market does not exist within any community.

Market is free by its nature, but free market does not exist because of the impediments to its freedom as a result of governmental or any other type of intervention.

The failure to realize prosperity, accompanied by the rise in poverty and decline in median income necessitate getting rid of such economic fallacies. No doubt that a system based on principles set by the Creator of the people is the best for all communities.

In general, all religions handled economic issues, but Islam has set constant comprehensive rules as guidelines for the establishment of a fair economic system which suits all people in different times and places.

* In the first chapter of the Holy Qur’an named Al-Fatihah, Muslims ask for guidance; *“Guide us to the straight way”*. In reply to their request, the second chapter named Al-Baqarah starts; *“This is the book, where is no doubt, a guidance to those who are the pious believers”.*
* The Holy Qur’an is in conformity with both Christianity and Judaism; *”We did send down the Taurat (Torah), therein was guidance and light … And whosoever does not judge by what Allah (God) has revealed, such are the disbelievers.”(Al-Ma’adah 5:44).*

*“and We gave him the Injill (Gospel), in which was guidance and light and confirmation of the Taurat …. Let the people of the Injill judge by what Allah has revealed therein. And whosoever does not judge by what Allah has revealed therein, such are the rebellious.” (Al-Ma’adah 5:46,47).*

*“And this (Qur’an) is a blessed book which We have sent down, confirming the Revelations which came before it” (Al-An’am 6:92).*

* The Holy Qur’an introduces a message for all people regardless of their beliefs.

*“We have sent down to you the book (Qu’an) for mankind in truth”(Az-Zumar, 39: 41).*

Taking into consideration the recent economic environment that is characterized by speculative mania and rapid increase in quantity of credit and money, different approach has been taken to identify economic topics and to understand verses of the Holy Qur’an in light of present complicated issues of economy. This explains the different presentation of Islamic economy in comparison with what was introduced by other researchers.

The analysis proceeds in six chapters. The first five chapters handles the main topics of economics; Production, Market and Prices, Money, Financial activities, and Distribution of wealth. Each chapter introduces the ideological viewpoints of Islam supported by the verses of the Holy Qur’an and the sayings (Hadith) of the Prophet ((Pbuh). Also it explains how Islamic economic principles can be implemented in real life forming a practical integrated self-correcting economic system. The final chapter briefly shows the features of the proposed economic system in comparison to present economic systems.

CHAPTER 1

PRODUCTION

Production refers to the activities which result in producing products, adding value to available products, moving products to a different time or place. It is the conversion of inputs into outputs. Products take the form of goods, services, or assets. A factory produces new product, a retailer adds marketing services to products, and a doctor provides professional services.

**Legality of Production**

The Holy Qur’an legalizes production.

*“Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent. And do not kill yourselves.”(An-Nisa’. 4:29)*

*“ whereas Allah has permitted selling and forbidden Riba” (Al-Baqarah. 2:275)*

In general, the word “Trade or Trading” in the Holy Qur’an refers to any form of investment in productive activity and the word “Selling or Sale” refers to the last stage of any investment transaction in which the profit is recognized as a result of the alienation of one or more of the property rights through cash or credit sale, rent or lease, rental sale, paying toll or fee to use, or any other legal way of alienation.

Both the production of consumer goods and the production of capital goods are legalized.

*“O mankind! Eat of that which is lawful and good on the earth”(Al-Baqarah. 2:168)*

*“And remember when He made you successors after ‘Ad people and gave you habitations in the land, you build for yourselves places in plains, and crave out homes in the mountains. So remember the graces bestowed upon you from Allah, and do not go about making mischief on the earth.”(Al-A’raf.7:74)*

**Regulations of Production**

The following verses of the Holy Qur’an regulate productive activities;

1. **Principle of mutual consent**

*“….. except it be a trade amongst you, by mutual consent”. (An-Nisa’. 4:29)*

1. **Principle of justice**

Fair wages

*“The way is only against those who oppress men and rebel in the earth without justification; for such there will be a painful torment”(Ash-Shura, 42:42)*

*“and reduce not the things that are due to the people”(Hud, 11:85)*

Fair company.

“*And, verily, many partners oppress one another, except those who believe and do righteous good deeds, and they are few” (Sad. 38: 24)*

1. **Prohibition of environmental mischief**

*“Evil has appeared on land and sea because of what the hands of men have earned (by oppression and evil deeds"(Ar-Rum, 30:41)*

1. **Illegal products**

Intoxicants

*“Intoxicants and gambling, and ….. are an abomination of Satan’s handiwork, So avoid that”. (Al-Ma’idah. 5:90)*

Specific kinds of meat

*“Forbidden to you are: the dead animals, blood, the flesh of swine, and that on which Allah’s name has not been mentioned while slaughtering, and that which has been killed by strangling, or by violent blow, or by headlong fall, or by the goring of horns, and that which has been partly eaten by a wild animal unless you are able to slaughter it before its death, and that which is slaughtered on stone-alters.”* *(Al-Ma’idah, 5:3)*

**Factors of Production**

Based on Islamic beliefs, people do not own factors of production. They are authorized to utilize resources, and they will be rewarded for their efforts.

1. **God is the only Creator**

*“Is there any creator other than Allah?”(Fater 35 :3)*

* God is the only creator of human resources.

*“Who created you from a single person, and from him He created his wife, and from them both He created many men and women”(An-Nisa, 4:1)*

* God is the only creator of natural resources.

*“He it is Who created for you all that is on earth …”(Al-Baqarah 2: 29)*

*“He revealed iron, wherein is mighty power and uses for mankind”(Al-Hadid 57 : 25*)

1. **God is the only Owner**

*“Unto Allah belongeth the Sovereignty of the heavens and the earth and whatsoever is therein, and He is Able to do all things.” (Al-Maeda 5:120)*

1. **People are trustees**

*“and spend of that whereof He hath made you trustees;”(Al-Hadid 57 : 7*)

1. **People are rewarded for their efforts only**

*“And that man hath only that for which he maketh effort”(An-Najim 53 : 39)*

Resources represent the raw primitive productive factors. There are two types of resources; human resources and natural resources. Not all natural resources can be utilized for production and not all human resources can be directed at production. Only labor force out of human resources may be employed for production. Out of natural resources, only discovered, dominated, and extracted materials may be exploited in production. The production process requires the combination of labor and materials. The combination cannot be achieved unless an investor is willing to bear investment risk. Accordingly, the factors of production and its returns may be classified as follows:

1. Material

Material includes those discovered and dominated natural resources, such as machines, roads, equipments, buildings, energy, seeds, and raw materials.

*“And We have given you (mankind) power in the earth, and appointed for you therein livelihood. Little give ye thanks!” (Al-Araf 7 : 10)*

Investors are obliged to pay for the material.

*“O ye who believe! Fulfill your undertakings.” (Al-Maeda 5 : 1)*

1. Labor

Labor refers to all types of physical and mental efforts directed at production. It includes planning, management, and decision-making.

*“And he was building the ship” (Hud 11 :38)*

*“He said: Set me over the storehouses of the land. Lo! I am a skilled custodian.”*

 *(Ysuf 12 : 55)*

In return for labor, the investor has to pay wages in cash or in form of benefits.

*“She said: Lo! my father biddeth thee, that he may reward thee with a payment for that thou didst water (the flock) for us.” (Al-Qasas 28 :25)*

*“He said: Lo! I fain would marry thee to one of these two daughters of mine on condition that thou hirest thyself to me for eight pilgrimages.” (Al-Qasas 28 :27)*

1. Risk

Investment risk is an intangible asset which causes hardship for the investor.

*“And that man hath only that for which he maketh effort”(An-Najim 53 : 39*

Profit is the return for the investment risk.

*“O ye who believe! Squander not your wealth among yourselves in vanity, except it be a trade by mutual consent” (An-Nisa 4 :29).*

According to this verse, profit is presented as an exception from eating property of others. Selling at cost changes the components of the personal wealth, but does not affect the value of the wealth, while selling at profit or loss causes an increase in the wealth of one party for a decrease in the wealth for the other party. Profit is regarded as reward given to investors for the hardship resulted from their contribution to the production process. In the absence of profit, there will be no incentive for investors to take investment risk.

**Accumulation of wealth**

As a result of the production process, wealth is accumulated. Islam recognizes the accumulation of capital.

*“and love wealth with abounding love.” (Al-Fajr 89:20).*

The term “Capital” is a confusing term. It has different meanings in dictionary. In ordinary usage, it is used to refer to money put into business by owners, wealth owned by a business, or net worth of business. For making it clear, each term related to the issue of accumulation of wealth is given a different meaning.

1. Properties

Properties refer to all owned tangible and intangible things. Property includes tangible assets such as real estate, goods, clothes, and food, in addition to all owned things such as money, authorship, trade marks and publishing rights. It also includes intangible assets such as personal qualifications and professional skills.

1. Wealth

Wealth represents all properties except money. The wealth of a country is not the money in its banks. It includes its roads, mines, farms, factories, schools, machines, and its inhabitants’ skills. In the Holy Qur’an wealth is referred to by the Arabic word “Amwal”.

*“Take alms of their wealth” (Al-Tawba 9:103).*

1. Money

Money is just a medium of exchange which measures value of products. It is not wealth. It is not a factor of production. Money is acquired to be transformed into products or factors of production. It represents potential products or potential factors of production.

1. Assets

Assets include all tangible properties including money. Due to its liquidity, money is considered as an asset. In present accountancy, some other properties, such as goodwill and personal qualifications are considered as part of the assets.

1. Liabilities

Liabilities represent total amount due to others. Creditors do not have ownership rights. They have the right to claim their debits. Their right may be guaranteed by collaterals on assets owned by the debtor or the guarantor. The following verse refers to liabilities.

*“When you contract a debt for a fixed period, write it down. Let a scribe write it down in justice between you……..And get two witnesses out of your own men”(Al-Baqarah, 2:282)*

1. Capital

Capital represents the net owned assets. It equals the difference between the total of assets and liabilities. The Holy Qur’an refers to the principal of a loan.

*“but if you repent, you shall have your capital sums.”(Al-Baqarah. 2: 279)*

1. Profit

Profit represents the amount by which capital is accumulated.

Accumulation of wealth is the result of generating profits as the return for bearing investment risk.

**Production in present economic systems**

Most economists classify the factors of production under four headings:

1. Land:

Land refers to all natural resources. Rent is the return to land.

1. Labor:

Labor refers to physical and mental efforts directed at production. Wages is the return to labor.

1. Enterprise:

Enterprise refers to the functions of planning, management, organization, and decision making. Profit is the return to enterprise.

1. Capital:

 Capital refers to private and public properties directed at production including money. Interest is the return to capital.

Capital is considered as one of the factors of production.

* Considering capital as one of the factors of production does not comply with the definition given by economists to the term “capital” as wealth set aside to produce future wealth and as the result of the production process.
* Accountants define capital as the wealth which is ventured by the business owners in order to carry out the objects of that business.
* Including money in capital as a factor of production contradicts the definition given by economists to money as anything acts as medium of exchange.

Interest is considered as the return to capital.

* In reality, interest is the return to borrowed money. It is not the return to machines, roads, materials, or seeds. It represents the reward to lenders.
* Borrowing is not necessary for production process. In case of sufficient capital, the production process can be accomplished without borrowing.
* Money should be first transformed into a real factor of production in order to deserve a return.
* Liquidation of capital terminates the production process.

In economic sense, the term “land”, as a factor of production, refers to the natural resources directed at production such as soil, wind, rain and rivers.

* Natural resources represent a gift created by God. Gift is not rewarded.
* Rent is paid for the use of some products such as buildings and machinery which are included in capital as a factor of production.

According to the present classification of factors of production, accumulation of capital is subject to generating profit plus interest.

* Viewing interest as a return to capital entitles investors to generate interest even if they do not borrow money.

Giving, to words, special meanings that do not correspond with ordinary usage reflect the pitfalls in economic thinking, and open the door to establish conclusions based on fallacies. Economists employ these fallacies in the classification of factors of production to legalize interest and initiate a lot of controversy about the concept of money and its value.

CHAPTER 2

MARKET AND PRICES

The term market refers to the conditions and relationships which exist when and where economic activities are conducted. The function of the market is to provide the conditions within which prices of the exchange transaction may be fixed. Normally, prices are determined by the market forces of demand and supply. The influence of the market forces varies according to the time period involved, the physical location of the market, the nature of the commodity, and the numbers of potential buyers and sellers.

**Islamic conceptual framework of pricing**

**Humanity disruption into the natural market price system is prohibited.**

*“And do not do mischief on the earth after it has been set in order …” (Al-A’araf, 7:56)*

Natural market is neither pure market nor perfect market as defined by economists. Simply, natural market is the environment in which natural price system is free of any human impediments to its action.

Natural price system is one of many natural systems created by God. It refers to the ability of the market to correct itself with no external intervention. It is the main core of Islamic economy. It represents the framework within which productive activities should take place. It provides appropriate conditions within which appropriate prices and terms are determined by mutual consent of related parties as a result of free interaction of demand and supply. Demand and supply fluctuate, but reach a temporary balance at an appropriate market price. Products are priced in term of money.

This principle requires the avoidance of all types of intervention into the natural price system;

1. **Prohibition of fixing prices**

*“Anas reported that the current price once became dear at the time of the Messenger of Allah. They asked: O Messenger of Allah! Fix a rate for us. The Holy Prophet replied: Verily Allah is One who controls price, curtails, gives amply and provides sustenance; and certainly I hope that I should meet my Lord while there will be none amongst you who will hold me responsible either for blood or for property.”(Tirmizi, Abu Daud, Ibn Majah)*

1. **Prohibition of monopoly**

*Ma’mar reported that the Messenger said: Whoever monopolizes is a sinner. (Muslim)*

1. **Prohibition of greed**

*“And O my people! Give full measure and weight in justice and reduce not the things that are due to the people”(Hud. 11:85)*

1. **Prohibition of present taxes**

Ordinary tax

*“And eat up not one another’s property unjustly nor give it to the rulers that you may knowingly eat up a part of the property of others sinfully ….” (Al-Baqarah. 2:188)*

Direct taxes cause inflation and severely disrupt the natural market pricing system.

* Taxes on products

Custom duties, production tax, purchase tax, and any other before-sale tax imposed on products are added to the cost of products.

* Income tax levied on suppliers

Suppliers care about their net after-tax profit by considering their income tax when calculating prices.

* Sales tax

Sales tax represents direct increase in market prices.

* Income tax paid by labors

Income tax paid by labors increase cost of labor and thus increase the total cost of products.

* Indirect taxes imposed on suppliers and labors

Social security tax which is paid by suppliers and labors increases cost of products.

Inflation tax

 *“and reduce not the things that are due to the people…” (Hud. 11:85)*

Currency devaluation and excessive expansion of money reduces the purchasing power of the currency. Suppliers have to pay higher prices for material and labor.

1. **Prohibition of speculative activities**

Speculation in assets

*“and maisir, and …, and arrows for seeking luck are an abomination of Satan’s handiwork, So avoid that”. (Al-Ma’idah. 5:90)*

The word used by the Qur’an for gambling is ‘maisir’ which literally means ‘getting something too easily’ or ‘getting a profit without working for it’. Speculative activities in financial markets are a sort of gambling.

Speculation in real estate as well as speculation in commodities and shares constitutes a type of interference in the natural market system because it is based on contracted demand and supply rather than real demand and supply. Speculative prices are subject to many factors such as economic indications, political issues, rumors, and psychological reactions. In most cases, prices reflect interests of large capitalists who dominate the speculative markets.

1. **Prohibition of financial corruption**

Corruption charges are added up, indirectly, to the cost of products for the purpose of calculating prices.

*“and Allah likes not mischief”(Al-Baqarah, 2:205)*

*“and do not commit mischief in the land causing corruption.” (Hud. 11:85)*

Financial corruption includes:

Deceiving

 *“And give full measure when you measure, and weigh with balance that is straight”*

*(Al-Isra’, 17:35)*

Bribery

 *“Abdullah-b-Amr reported that the Messenger of Allah cursed the bribe-taker and the bride-giver.” (Abu Daud, Ibn Majah)*

Theft

*“O Prophet! When believing women come to you to give you the pledge, that they will not associate anything in worship with Allah, that they will not steel, that they will not commit illegal sexual intercourse, that they will not kill their children, that they will not utter slander intentionally forging falsehood, and that they will not disobey you in what is right, then accept their pledge, and ask Allah to forgive them.”(Al- Mumtahanah, 60: 12)*

Embezzlement

*“Verily, Allah commands that you should render back the trusts to those, to whom they are due”(An-Nisa, 4: 58)*

1. **Illegal methods of sales**

Freedom of the market helps realization of mutual consent without external effects.

*“….. except it be a trade amongst you, by mutual consent”. (An-Nisa’. 4:29)*

The Prophet (Pbuh) prohibited those types of sales where the mutual consent may not be realized.

Gharar sale

*“On the authority of Abu-Hurayra (mAbwh) that: The prophet (Pbuh) prohibited the pebble sale and the Gharar sale”(Muslim, Abu Dawud)*

The word “Gharar” refers to the sale of products whose existence or characteristics are not certain such as the sale of fish in the sea, unborn calf in its mother’s womb, birds in the sky, runaway animal, and un-ripened fruits on the tree.

Sale of what is not in possession

*“Hakim-bin-Hezam reported: The Messenger of Allah prohibited me to sell what is not in my possession.” (Tirmizi)*

Forced sale

*“Ali reported that the Messenger of Allah forbade the (forced) purchase from a needy person, and purchase from the inconsiderate and purchase of fruit before it reaches maturity.” (Abu Daud)*

Deceiving

*“Waselah-bin-Asqa’a reported: I heard the Messenger of Allah say: Whoso sells a defective thing without disclosing it continues to be in the wrath of Allah or angels continue to curse him.”(Ibn Majah)*

**Prices in Natural Market**

Adam Smith, in his book “The Wealth of Nation” (1776) refers to the natural price system as “invisible hand”. Smith says, "If a product shortage were to occur, that product's price in the market would rise, creating incentive for its production and a reduction in its consumption, eventually curing the shortage. The increased competition among manufacturers and increased supply would also lower the price of the product to its production cost plus a small profit, the "natural price." Smith believed that while human motives are ultimately out of self interest, the net effect in the free market would tend to benefit society as a whole.

On the one hand, prices are fixed by demand and supply, but on the other hand, determination of the two forces of the market is dependent on prices. Demand refers to the quantity of a product asked to be bought at a particular price. The lower the price of a product, the greater will be the quantity demanded. Supply refers to the quantity of a product offered for sale at a particular price. The higher the price of a product, the greater will be the quantity supplied.

A rise in the production cost, supplier’s profit margin, or volume of demand relatively to the volume of supply results in natural price increase. The natural rise in price of a product has negligible impact on the general price level. Freedom of the market ensures determination of fair prices of products, fair wages for labors, and stability of the general price level;

* The higher price encourages investors to increase quantity of supply. The lower price encourages consumers to increase quantity of demand. Natural free interaction of demand and supply returns the market price to the equilibrium point where quantity of demand equals quantity of supply.
* The huge variety of products makes the increase in prices of some products is compensated by a fall in prices of some other products and also makes the fall in supply of some products is compensated by a rise in supply of some other products.
* Continuous discoveries and technological developments provide new products, cheaper substitutes, and new methods of production. A consumer can now acquire a new TV set produced in 1999 for less than its market price at the year of production.
* The increased competition among suppliers results in determination of fair profit rates.

**Prices in present economic systems**

In present economies, free market does not exist because of the existence of impediments such as:

* Legislations affecting prices and wages. Prevention of greed is presented as justification to governmental intervention. The objective can be achieved through fair competition.
* Legalized monopoly. Taking advantage of large-scale economies of production and specialization are claimed as an advantage for monopoly. Monopoly causes abnormal price increase because monopolists have control over the supply and may fix the price. Such advantages are taken by one supplier, more than one supplier, or an organization forming a cartel, holding company, trust, or pool. Any special advantages given to a supplier is considered as a type of monopoly.
* Some techniques, such as advertising, seek to alter consumer preferences and affect demand.

The market price of a product is what the consumer is actually paying to acquire the product. For setting a market price of a product, a supplier considers the total cost of the product in addition to certain profit. Production cost of a product includes cost of material and labor used for production, marketing, transportation, and management. Fair price of a product equals its production cost in addition to reasonable profit as return to investment risk. The fair price of a product is what the product is fairly worth.

In present economic systems, the market price of a product is much higher than its fair price because the total cost includes additional charges over the production cost. Such charges, which are not related to production, will be referred to as “inflation charges”. Inflation charges represent the excess of the market price of a product over its fair price.

Inflation charges include all present taxes, inflation tax, finance charges, other charges due to financial corruption, monopoly, and speculative activities, and the supplier’s profit on inflation charges.

Inflation charges cause accumulated rise in general level of prices. An increase in the general level of prices implies a decrease in the purchasing power of the currency. Inflation has harmful impacts on economy. Demand falls because each monetary unit buys fewer goods and services. Supply and national product decline because prices of raw material soar and pressure for increased wages mounts to keep up with consumer prices. The fall in supply raises unemployment rate. Exports become more expensive to sell, while imports increase because they are relatively cheaper than locally produced products. Saving is discouraged because of the increased prices of consumer products. National product evaluated at market price may increase as a result of inflation giving vague indicator on economic performance. Evaluation of national product should consider production cost or fair price.

The effect of inflation is not distributed evenly. Those on fixed incomes such as pensioners suffer a decline in their living standards, while those with variable incomes such as suppliers stand to gain from the increased profits. As a result of the increased cost of living, inflation charges cause further rise in wages and consequent increase in total cost of products.

Some economists recommend living with moderate inflation claiming that it provides a new incentive for investment as long as prices are rising and are expected to continue rising. But, inflationary process is potentially unstable, and can accelerate into hyperinflation and the very rapid inflation can cause a breakdown of the market economy. Inflation causes reversal distribution of income of people among investors. In general, inflation charges represent much more than 100% of the production price of products. Discarding inflation charges will result in dramatic decrease in price level and increase in quantity of national products and exports in favor of a fall in unemployment rate.

CHAPTER 3

MONEY

Economists define money as anything that is widely used as means of exchange. Money is not, in itself wealth. It is just a social convention needed to facilitate the process of exchanging products. It was a product made of precious metal, but it is no longer a product. Nowadays, money is made of material of negligible cost. It is either paper money or coins issued by the monetary authority, substitute money such as checks representing bank deposits, or credit money.

**Nature of Money**

Simply, money is an acceptable and exchangeable medium of exchange. As a medium of exchange, money must act as a measure of value and as a store of value.

As a measure of value, money enables its holders to measure value of products in terms of generally accepted monetary units. To fulfill this function, money must;

1. Act as common denominator so that products can be valued and compared in common terms.
2. Act as a unit of account through expressing value of products in term of currency units for purposes of calculating and recording exchange transactions.

As store of value, money is capable of being exchanged for products of certain value at anytime in the future. To fulfill this function as a store of value, money must;

1. Confer general purchasing powers on its holders. It gives to its holders a right, which can be exercised at any time, to obtain products.
2. Have a stored value.

**Currency Backing**

Currency backing is just a historical tradition. Viewing money as a substitute of a product followed the transformation from the barter system to the gold system and at later stage to the gold bullion standard where paper money was convertible into real gold. In present economic systems, the currency backing tradition has been followed by choosing the US dollar as the international reserve currency.

In his book “Modern Economics – Principles and Policy (1972), Kelvin Lancaster of Colombia University says “From one point of view, currency backing is inherently ridiculous and based on public lack of comprehension about the nature of money, but it has one aspect that was of great historical importance: If the currency must be backed, wholly or partially, by something that is inherently scare, there is a built-in-guarantee that the currency itself will remain scarce.”

The real backing of the currency is the confidence that the currency gives to its holder a right, which can be exercised at any time, to obtain products for the value of money. Such confidence may not be established unless it is protected by law and can be practiced. Practicing this right requires the availability of national product as the material currency backing.

From the Islamic viewpoint, Currency backing is regarded as a sort of illegal hoarding of money, gold, and silver.

 *“Woe to every slanderer and backbiter. Who has gathered wealth and counted it. He think that his wealth will make him last forever. Nay! Verily, he will be thrown into the crushing Fire.” (Al-Humazah.104: 1-4)*

*“And those who hoard up gold and silver and spend them not in the way of Allah, announce unto them a painful torment” (Al-Taubah. 9:34)*

In practice, getting rid of the currency backing is justifiable;

* Most of the money in circulation worldwide is substitute money, not issued money. Issued money in USA as at January, 2007 was 750.5 billion dollars, while commercial bank money (in M2) was 6.33 trillion dollars.
* Despite of issuance of fiat money and the huge expansion of credit, US products do not lose their value. Even in the very weak economies where currency is sharply devaluated, nobody can obtain products without paying the market price.
* Backing gives a changeable value to the currency unit. Money issued in gold or other metal derives its value from the price of the material from which it is made. Money backed by gold, silver, or other foreign currencies derives its value from the material by which it is backed. The value of fiat and credit money is enforced by law. The value of the backing material fluctuates as a result of the interaction of the forces of the market and the value determined by law changes as a result of the intentional changes in quantity of money. Giving a changeable value to the currency unit does not comply with the function of money as a common denominator to measure values of products.
* Issuance of fiat money for public debt contradicts the definition of debt as a result of borrowing or credit sale. Issuance of fiat money is a process of issuing valueless thing because money acquires its value when it is used as a medium of exchange. Public debt is paid by people in form of taxes.
* When government converts gold into currency, people use the currency to buy products and currency remain in circulation while government still has the gold. When the currency is worn out, the issuer buys it back at face value, thereby balancing exactly the revenue received when it was put into circulation. Seignorage results in devaluation of private properties. Governments are relying heavily on seignorage as a source of revenue. For example: The [U.S. Treasury](http://en.wikipedia.org/wiki/U.S._Treasury) estimates that it has earned about US$4600 million in seignorage from taking out of circulation the “50 State” series of quarters which was launched in 1999.
* Backing materials can be utilized in productive activities.

**Value of Money**

1. Money has no intrinsic value

Money is just a medium of exchange acts as a measuring rode. Money, like any other measuring unit, has no intrinsic value by itself. The measure of Kilo is available in face values of 1, 2, 5, … kilos, also the measure of US Currency is available in face values of 10, 20,100, … dollars. A certain length of a road may not be measured as 10 kilometers in a certain moment changeable to 11 kilometers in other moment without the road becomes longer. Similarly, a ton of cement may not be valued for $40 in a certain moment changeable to $45 in other moment without the market price determined by demand and supply becomes higher.

1. Money earned its value from the price

Money measures value (price) of products. Money derives its value from the price of the product subject to evaluation. The relationship between prices and value of money is quite simple.

* Derivative value of the currency unit = 1**/** the price of the product

The price of a product represents its value in term of currency units. Similarly, the value of the monetary unit can be expressed in term of units of the product. If the price of 2 pencils equals $1, it is a matter of truism to say that $1 equals 2 pencils each of them worth $0.50. In other words, the currency unit earned a value of 2 (1 **/** 0.50) where the dollar is expressed by units of pencils.

1. Money derives its value from the general price level.

As a medium of exchange, money is needed to be exchanged for any product. For being capable to be exchanged for any product, money derives its value from the general price level. The general price level represents the price of one general unit of the national product where the general unit of the national product is an imaginary unit calculated by dividing the amount of national product by the general price level.

Based on truism, the relationship between the general price level and value of money can be stated as follows:

* Value of the currency unit = 1**/** General Price Level ……. OR
* Value of the currency unit = Quantity of National Product **/** Amount of National Product in currency units.

This is true on the assumption that national income equals money supply. In practice national income does not equal money supply. This raises the issue of the velocity of circulation of money. Money is used for more than one time in economic activities. The rate at which money changes hands is known as the velocity of money.

On the aggregate level, the relationship between output and income shows that:

* National Product = Money Supply X Velocity = National Income

Taking the velocity issue into consideration, the relationship between the general price level and value of money can be stated as follows:

* Value of the currency unit = Velocity **/** General Price Level
1. Derivative value must be stable

The most important characteristic of any measuring tool is its stability so that it can give the correct and fair value of the subject matter. Stability of the value of the monetary unit raises the issue of present and future value of money. Money gives to its holders a right to obtain products for the derivative value at the time of measurement (Present value). This right shall be exercised at any time in the future where the derivative value will differ (Future value). The Holy Qur’an introduces the evaluation concepts.

* Prohibition of appreciation

*“Allah has permitted selling and forbidden Riba” (Al-Baqarah. 2:275)*

Prohibition of riba requires that money should not gain extra value in return to the lapse of time. In other words the future value of money should not exceed its present value.

* Prohibition of devaluation

*“and reduce not the things that are due to the people”(Hud, 11:85)*

Money is something due to people. This principle requires that the value of money should not be intentionally devaluated.

* Prohibition of the humanity disruption into the natural market system.

*“And do not do mischief on the earth after it has been set in order ”*

*(Al-A’araf, 7:56)*

Products are priced in term of money. This principle requires that prices of products should not be affected by the use of money as unnatural standard custom.

* Principle of fair valuation

*“And O my people! Give full measure and weight in justice….” (Hud. 11:85).*

Money acts as a measure of value of products. This principle requires that the value of a product should be fairly measured and the money should express the exact value of the underlining product.

According to the verses, money should not gain or lose value for the lapse of time. Giving fair value to the monetary unit requires the stability of the value of the currency unit so that the holder can obtain products of future amount equals the amount of the products he might acquire when he receives the money.

Stability of the derivative value of the currency unit does not mean that it should derive a constant value; but it means that the change in its derivative value should retain the future amount of products in exchange for the currency unit equals the present amount of products in exchange for the currency unit. The equality of future and present amount of products in exchange for the currency unit can be realized only if the following equilibrium equation is true.

V\*G (at the date of receipt of money) = V\*G (at the date of exchange of money)

Where; V stands for “Value of currency unit in term of general units of products” and G stands for “General Price level”.

In practice, this equation is not always true because the production process is a dynamic process where money supply, quantity and prices of products are variables. Again, this raises the issue of the velocity of circulation of money.

1. Velocity = 1

Having velocity = 1, should the national product equals 10 billion dollars and the general price level equals 1.25 (relatively to the general price level at the base year which equals 1), then it can be said that the quantity of national product equals 8 billion units (10 billion dollars **/** 1.25), and the value of the currency unit equals 0.8 of general units of products (1 **/** 1.25).

Assume that the national product increased to 12 billion dollars and the general price level went up to 1.6, then it can be said that the quantity of national product equals 7.5 billion units (12 billion dollars **/** 1.6), and the value of the currency unit equals 0.625 of general units of products (1 **/** 1.2).

In this example, the legal right of the holder of the currency unit is retained because V\*G (before the change) = V\*G (after the change)

(0.8 general units of products X 1.25 General Price Level) **=** 1

(0.625 general units of products X 1.6 General Price Level) **=** 1

1. Constant Velocity

Having velocity = Constant number = 2, should the national product equals 10 billion dollars and the general price level equals 1.25, then it can be said that the quantity of national product equals 8 billion units (10 billion dollars **/** 1.25), and the value of the currency unit equals 1.6 of general units of products (2 **/** 1.25).

Assume that the national product increased to 12 billion dollars and the general price level went up to 1.6, then it can be said that the quantity of national product equals 7.5 billion units (12 billion dollars **/** 1.6), and the value of the currency unit equals 1.25 of general units of products (2 **/** 1.6).

Also in this example, the legal right of the holder of the currency unit is retained because V\*G (before the change) = V\*G (after the change)

(1.6 general units of products X 1.25 General Price Level) **=** 2

(1.25 general units of products X 1.6 General Price Level) = 2

1. Variable Velocity

Given velocity = 2, should the national product equals 10 billion dollars and the general price level equals 1.25, then it can be said that the quantity of national product equals 8 billion units (10 billion dollars **/** 1.25), and the value of the currency unit equals 1.6 of general units of products (2 **/** 1.25).

Assume that velocity increased to 2.4 and the national product increased to 12 billion dollars and the general price level went up to 1.6, then it can be said that the quantity of national product equals 7.5 billion units (12 billion dollars **/** 1.6), and the value of the currency unit equals 1.5 of general units of products (2.4 **/** 1.6).

In this example, the legal right of the holder of the currency unit is NOT retained because V\*G (before the change) DOES NOT EQUAL V\*G (after the change)

 (1.6 general units of products X 1.25 General Price Level) **=** 2

(1.5 general units of products X 1.6 General Price Level) = 2.4

On the one hand, velocity of circulation, in real life, is a variable; on the other hand, constancy of the velocity is required for the stability of the value of the currency unit.

The classical quantity theory of money can be stated as follows:

Quantity of National Product X General Price Level = Money Supply X Velocity of Circulation of Money = National income.

The equation shows that:

1. The production process is a dynamic process.
2. The quantity of national product, general price level, and quantity of money are interrelated variables.
3. The velocity of circulation is not a constant number. Its changes depend upon the changes in the quantity of national product, general price level, and quantity of money.
4. The change in the velocity of circulation represents the outcome of the changes in the quantity of national product, general price level, and quantity of money.

In productive free economy, both the quantity of national product and the general price level should not be subject to control. The only way to convert the variable velocity to a constant velocity is to change the quantity of money supply.

**Quantity of Money**

Excluding transactions of foreign currency exchange, all economic transactions represent internal transfers. A payment made by one party will be received by another party within the community. If a person buys a product, the seller will receive the payment. If a contractor builds a hospital, then engineers, sellers of materials, and labors shall receive the payments. A constant quantity of money produces higher volume of production depending upon the velocity of money.

Whenever transactions involve exchange of foreign currency for local currency, the quantity of money will change. Changes in the quantity of money are dependent upon the quantity of the local currency received or paid as a result of the exchange transactions between the local currency and foreign currencies. A rise in the quantity of money due to the foreign currency transactions translates the increase in the volume of exports, foreign investments, tourism activities, and inward transfers. It is the responsibility of the government to deal with the fundamental causes of the reduction in the quantity of money and to halt the deficit on the balance of payments through improvement of controls on foreign currency transactions, economic policies and plans, encouragement of foreign investments, taking necessary actions to ensure political and financial stability, and setting rules to protect domestic production.

For stabilizing the value of the monetary unit, the government, in response to the changes in production, shall increase or decrease, periodically, the quantity of money supply to the extent that returns back the velocity of circulation to its base value. The intentional expansion of money supply over the determined limit results in inflation and constitutes an intervention into the natural market system.

The classical quantity theory of money can be stated as follows:

Q\*G = M\*T

Where; Q stands for “Quantity of National Product”, G for “General Price Level”, M for “Money Supply”, and T stands for “Velocity of circulation of Money”.

The following table illustrates the process of adjustment to reach the equilibrium point.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Date | Q | G | Q\* G | M | T=Q\*G**/**M | M\*T=Q\*G | Value of currency unit (V) | EquilibriumV\*G |
| Base | 1000 | 1.25 | 1250.0 | 625.000 | 2 | 1250.0 | 1.6 | **2** |
| Change | 1005 | 1.26 | 1266.3 | 630.000 | 2.01 | 1266.3 | 1.595238 | 2.01 |
| Adjusted | 1005 | 1.26 | 1266.3 | **633.150** | 2 | 1266.3 | 1.587300 | **2** |
| Remarks:* Value of currency unit (in term of general units of products) = T **/** G
* Adjusted **M** = Q\*G at adjustment date **/** T at base date
* The adjustment process stabilizes the value of the currency unit:

(1.6\*1.25) at base date = (1.5873\*1.26) at adjustment date = 2 * The adjustment process results in an increase of money supply. The increase was translated into output during the period of change, thus it will not cause inflation.
* The increase in M during the period of change results from foreign exchange transactions.
* Currency backing =Value of money supply (in term of general units of products) = M\* V
 |

For the government to be able to stabilize the value of the monetary unit, the whole quantity of money should be circulated through the monetary authority. Setting money under control of the government is justified. The government guarantees the rights of the money holders. When money is not in use, it represents legal right not private property.

Money shall be circulated through the branches of the monetary authority in form of free of interest demand deposits. In compliance with Islamic rules, a guaranteed deposit may not generate profit.

* Money is mainly deposited on trust bases. Each deposit represents entrusted money.

*“Verily, Allah commands that you should render back the trusts to those, to whom they are due”(An-Nisa, 4: 58)*

* The legal right stored in money should be guaranteed by the government; otherwise money loses its public acceptability. Each deposit represents guaranteed money.

*Hadith “Al kharaj bel Daman” (Abu Daud, Ibn Majah)*

The Arabic word “Al kharaj” refers to any type of revenue as a result of investment and the Arabic word “Daman” refers to the guarantee. The meaning is that the Prophet, peace upon him, said that, the profit of guaranteed money is for the guarantor.

* Money, by itself, should not generate profit. Each deposit represents money.

*“and forbidden Riba” (Al-Baqarah. 2:275)*

Having all money, including the money with the government and the banking system, circulates through the monetary system;

* Cash money shall be replaced by units of account translate movements of the deposit accounts.
* All payments shall be made through transfers within the monetary system using available banking withdrawal instruments such as checks, transfers, electronic cards, and withdrawals via Internet.
* Production shall naturally control quantity of money. The government shall watch, periodically, the changes in national product and act accordingly for stabilizing the value of the monetary unit. The balance of the account of the public treasury with the monetary authority shall be increased or reduced relatively to the change in the quantity of national products. The change shall affect the public expenditure in favor of the whole society.
* For sundry expenses, prepaid electronic cards (similar to prepaid phone cards), prepaid checks (similar to cashier or certified checks) or prepaid bank notes in several denominations (similar to travelers checks) shall be issued by the branches of the monetary authority to replace cash money. Instead of government, people, as the real owner of money, shall be the issuer of money. Issuance of money shall not result in debts, because issued money shall be immediately debited to the account of the issuer. On presentation of the card, check, or note for clearance, issued money account with the issuer shall be reconciled.
* To encourage consumption, the branches of the monetary authority may issue free of interest credit cards to be used by individuals for buying consumer goods. In return, the authority may charge the sellers a service fees. Terms and ceiling of the card is determined in light of the income and the creditability of the holder.
* Total balance of deposits shall represent quantity of money.
* Total of payments through the monetary system shall represent the volume of economic activities.
* Local public debt shall be deleted because all the currency units issued by the government shall be withdrawn.
* The government shall not be liable to retain currency reserve.
* Money supply shall be backed by the national product.
* The velocity of money will increase because all available money shall circulate within the monetary system. Payments equal receipts.
* Branches of the monetary authority shall provide all types of banking services.
* Each deposit account provides complete record of the income and payments of the account holder. The records help creditability studies, combating corruption and proper calculating of tax. Data retrieved from foreign currency accounts help controlling the balance of payments.

**Foreign Exchange**

Foreign currency exchange is implicitly legalized in the Holy Qur’an.

*“and have made you nations and tribes that ye may know one another”(Al-Hujraat 49 :13).*

The value of a currency unit reflects the legal right given to the holder to acquire potential products of equivalent value. Currency exchange is regarded as a process of exchanging the legal right of acquiring domestic potential products for the legal right of acquiring foreign potential products.

The domestic value of currency is determined within the domestic markets, while the currency exchange process is conducted within the International market. Prohibition of the humanity disruption into the natural market pricing system requires that the exchange rate must be determined by the natural price system within the natural international market system.

*“And do not do mischief on the earth after it has been set in order” (Al-A’araf, 7:56).*

Determination of the exchange rate through the natural price system requires prevention of all types of intervention into this system. Prohibited intervention includes internal controls over exchange rates and external effects of globalization. The use of the dollar, or any other currency or basket of currencies, as international reserve is a type of disruption into the natural price system, because the fluctuation of the reserve currency has effect on the exchange value of other currencies. Over and above, the impacts of the economic problems arise in the country, or countries, of the reserve currency spread worldwide very rapidly.

Money exchange can be protected against exchange risk if a new international currency is considered as medium of exchange of currencies. The international currency unit shall represent a unit of account (Currency unit). There will be no physical international currency and no one will issue it.

As starting point, an initial value shall be given to each currency. The initial value shall be equal to the exchange rate of the currency unit for one dollar at that starting point. The initial value shall be considered as the exchange rate of the currency for the international currency at that starting point. The value of each currency is subject to changes in response to the changes in its domestic value and the interaction of demand and supply in the natural international market. Such changes shall be directly translated directly into proportional change in its exchange rate for the international currency. Unlike the exchange rate of currencies where each currency is given buy and sell rates, international currency shall be given just one medium rate so that to avoid overcharging the cross rates. The cross exchange rate shall determine the exchange rate between the currencies of different countries.

The international currency unit shall act as an independent accounting unit of constant value and shall be circulated only through the central banks all over the world. On the national level, the central bank shall act as the only covering reimbursing bank for transactions conducted by local exchangers. On the global level, a nominated international bank shall act as the only clearing house for the transactions between national central banks.

The international currency is not presented to provide facilities for saving purposes or to lend money. Balances of the international currency shall be free of interest in order to force countries, individuals and corporations with surplus funds to expand domestic investment or invest directly in other countries.

In theory, total balance of international currency accounts on the global level with the international bank should equal zero, but in reality, positive balances shall exist because of the clearing time difference worldwide in addition to the desire of retaining balances for liquidity purposes.

Taking into consideration the liquidity ratios, the international bank shall invest available balances of international currency in form of profit and loss sharing contracts for the development of poor countries. Accumulated net profits of the international bank shall be reinvested in same way.

**Money in present economic systems**

In present economic systems, money refers to any financial instrument that can fulfill the functions of money. Mainly three types of different money are in use; Reserve-backed money, fiat money and credit money.

Value of reserve-backed money depends upon the value of the backing material of both the local currency and the reserve currency. Fiat money initiates public debt. Banks introduce financial instruments as credit money. The transformation of debt to money involves some elements of risk. The claimant may default. The real value upon fulfillment will differ from the real value expected at the time of purchase. A claim to money may be transferred over and over again in an indefinite number of indirect exchanges without the person by whom it is payable ever being called upon to settle it.

The progressive shift from production to financial and speculative activities is the result and the reason of the excessive expansion of quantity of money over the needed quantity for exchanging products. Instead of directing all resources toward productive activity, non-productive sector of the economy has provided a considerable outlet for seeking profit in form of interest or through asset appreciation. The shift inflicts the greatest harm to the society in form of unemployment, inflation, inequitable distribution of income and wealth. Most of capital invested in financial markets represents money not owned by investors themselves. Banks and financial institutions lend speculators money borrowed from depositors. Premiums paid by people to social security, retirement entities, and insurance companies are deposited into bank accounts or invested in speculative activities and financial markets.

In its effort to control money supply, authorities apply monetary controls over interest rate, government expenditure, taxes, expansion of money, and currency exchange rate. The common effect of all these remedy tools is that they control, directly or indirectly, the expansion of credit. Credit squeezes may discourage investment in financial economy, but it causes economic slump, reduces national product, and raises unemployment rate. Expansion of credit may stimulate investment in financial economy, but it has bad impact on productive economy because it raises the inflation rate and develops destructive inflation’s consequences. Monetary authority tries to balance between positive and negative results of the controlling process, but in all cases they cannot prevent the economic instability. Markets may not respond in the way expected by the authority.

A failed monetary policy can have significant detrimental effects on the society. These include hyperinflation, stagflation, recession, high unemployment, shortages of imported goods, inability to export goods, and even total monetary collapse. The use of public funds to support financial institutions and speculators is a sort of social oppression because people have to settle the public debts via increased taxes.

As a result of globalization and technological developments, financial markets, money markets, stock markets, and commodities markets all over the world are, directly or indirectly, linked together. Globalization raises the issue of the impact of economic performance of other country on domestic economy and the need to avoid such country risk. As the largest economy in the world, U.S. currency dominates international markets and trade. The 2008 U.S. financial crisis badly affects almost all countries worldwide. Country risk is taken because of retaining the U.S. currency.

CHAPTER 4

FINANCIAL ACTIVITIES

In present economic systems, financial activities include lending transactions, speculative activities, and finance. Lending refers to the transactions that involve exchange of money for debts. Speculative activities represent transactions of buying assets for the purpose of generating profits resulted from price appreciation. Finance introduces contribution to investments with or through others. Finance creates an ownership relation while lending gives a right to the lender to claim his debt.

**Lending**

1. **Prohibition of usury**

Usury is the practice of lending money for generating riba. According to the Holy Qur’an, the word “Riba” refers to any direct or indirect return for lending. It may be called interest, commission, profit, financing charges, debt service, or fees, and may take a form of a service or any other type of benefits.

*“Those who eat Riba will not stand except like the standing of a person beaten by Satan leading him to insanity. That is because they say: “Selling is only like Riba,” whereas Allah has permitted selling and forbidden Riba” (Al-Baqarah. 2:275)*

 *“O you who believe! Be afraid of Allah and give up what due to you from Riba, if you are believers. And if you do not do it, then take a notice of war from Allah and His Messenger, but if you repent, you shall have your capital sums. Deal not unjustly and you shall not be dealt with unjustly. (Al-Baqarah. 2:278 – 279)*

Usury is forbidden with no exceptions

* Related to the purpose of borrowing

*“and forbidden Riba” (Al-Baqarah. 2:275)*

* Related to the amount of riba.

*“but if you repent, you shall have your principal sums” (Al-Baqarah, 2:279)*

* Related to the method of calculating the riba. (Simple, compound, or multiplied)

*“Eat not riba doubled and multiplied” (Al-Imran,3: 130)*

In addition to Islam, Christianity and Judaism forbid usury.

*“Give back to them immediately their fields, vineyards, olive groves and houses, and also the usury you are charging them—the hundredth part of the money, grain, new wine and oil."*

*(*[*Nehemiah 5:11*](http://www.biblegateway.com/passage/?book_id=16&chapter=5&verse=10&end_verse=12&version=31&context=context)*)*

*“who lends his money without usury and does not accept a bribe against the innocent. He who does these things will never be shaken.”(*[*Psalm 15: 5*](http://www.biblegateway.com/passage/?book_id=23&chapter=15&verse=4&end_verse=5&version=31&context=context)*)*

*“He does not lend at usury or take excessive interest. He withholds his hand from doing wrong and judges fairly between man and man.”(*[*Ezekiel 18:8*](http://www.biblegateway.com/passage/?book_id=33&chapter=18&verse=7&end_verse=9&version=31&context=context)*)*

*“He withholds his hand from sin and takes no usury or excessive interest. He keeps my laws and follows my decrees. He will not die for his father's sin; he will surely live”(*[*Ezekiel 18:17*](http://www.biblegateway.com/passage/?book_id=33&chapter=18&verse=16&end_verse=18&version=31&context=context)*)*

*"But love ye your enemies, and do good, and lend, hoping for nothing again; and your reward shall be great". (Luke 6:35)*

*“If thou lend money to any of My people, even to the poor with thee, thou shalt not be to him as a creditor; neither shall ye lay upon him interest.” (*[*Exodus, 22:24*](http://mechon-mamre.org/p/pt/pt0222.htm)*)- Hebrew Bible*

*“And if thy brother be waxen poor, and his means fail with thee; then thou shalt uphold him: as a stranger and a settler shall he live with thee. Take thou no interest of him or increase; but fear thy God; that thy brother may live with thee. Thou shalt not give him thy money upon interest, nor give him thy victuals for increase.” (*[*Leviticus, 25:35-37*](http://mechon-mamre.org/p/pt/pt0325.htm)*)- Hebrew Bible*

*“Thou shalt not lend upon interest to thy brother: interest of money, interest of victuals, interest of any thing that is lent upon interest. Unto a foreigner thou mayest lend upon interest; but unto thy brother thou shalt not lend upon interest; that the LORD thy God may bless thee in all that thou puttest thy hand unto, in the land whither thou goest in to possess it.” (*[*Deuteronomy, 23:20-21*](http://mechon-mamre.org/p/pt/pt0523.htm)*)- Hebrew Bible*

Difference between Usury and Selling

*“Those who eat riba... they say: Selling is only like riba”(Al-Baqarah. 2:275)*

The argument stated in this verse of the Holy Qur’an indicates the importance of understanding the difference between usury and selling.

The logic behind the argument is that the difference between the price of a product for cash sale and its price for credit sale represents the time value of money. Similarly, the Riba is the time value of money. This type of similarity may be true to an extent, but the discrepancy should be considered.

* Usury represents a transaction of exchanging money for debt, while credit sale refers to a transaction of exchanging real product for debt.
* Riba may be considered as the time value of money, while profit, from sale, represents the return to investment risk. For the cash sale, such risk increases by the lapse of time from the date the investor starts his investment to the date of sale. In case of the credit sale, the period of investment risk extends up to the date of the full settlement of debt.
* The investor may bear loss instead of generating profit, while the lender generates predetermined return.
* Profit is the investor’s reward for increasing national product and national supply and therefore helps price reduction, while Riba is added to cost of products and hence causes inflation.
* Selling is the base of the real productive economy which results in prosperity, while usury is the base of present financial economy which causes havoc in society.
1. **Legality of interest-free lending**

*“O you who believe! When you contract a debt”(Al-Baqarah, 2:282)*

If lending does not involve riba, it will not cause inflation. Interest-free lending is regarded as a social financial aid. Following verses regulate the interest-free lending.

Term

*“O you who believe! When you contract a debt for a fixed period”(Al-Baqarah, 2:282)*

Writing

*“O you who believe! When you contract a debt for a fixed period, write it down. Let a scribe write it down in justice between you…….” (Al-Baqarah, 2:282*

Witnesses

*“And get two witnesses out of your own men.”(Al-Baqarah, 2:282)*

Collaterals

*“then let there be a pledge taken, then if one of you entrusts the other, let the one who is entrusted discharge his trust”(Al-Baqarah, 2:283)*

No return

*“ you shall have your capital sums” (Al-Baqarah, 2:279)*

Collection

*“And if the debtor is in a hard time, then grant him time till it is easy for him to repay; but if you remit it by way of charity, that is better for you if you did but know.”*

*(Al-Baqarah, 2:280)*

**Speculative activities**

1. **Prohibition of speculation in prices of assets**

*“and maisir, …, and arrows for seeking luck are an abomination of Satan’s handiwork, So avoid that”. (Al-Ma’idah. 5:90)*

The word used by the Qur’an for gambling is ‘maisir’ which literally means ‘getting something too easily’ or ‘getting a profit without working for it’. Speculative activities represent a sort of gambling.

*“And do not do mischief on the earth after it has been set in order …”*(Al-A’araf, 7:56)

Speculation is a form of intervention into the natural market system. The price of an asset in speculative markets does not reflect free interaction of real demand and supply on the asset. Prices are subject to many factors such as economic indications, political issues, rumors, and psychological reactions. In most cases, prices reflect interests of large capitalists who dominate the speculative markets.

*“And O my people! Give full measure and weight in justice….” (Hud. 11:85).*

In speculative markets, prices do not reflect fair value of underlying assets. Optimistic speculations raise market prices, while pessimistic speculations cause market decline.

*“They ask you concerning alcoholic drink and maisir. Say: In them is great sin, and some benefits for men, but the sin of them is greater than their benefit”(Al-Baqarah 2 : 219).*

This verse refers to the conflict between the interest of speculators and the interest of the society with regard to speculative activities.

1. **Prohibition of speculation in interest**

*“whereas Allah has permitted selling and forbidden Riba” (Al-Baqarah. 2:275)*

Banning of riba is not limited to lending transactions, but it is also forbidden if it exists in exchanging products.

1. **Prohibition of speculation in currency exchange**

 *“The prophet (Pbuh) prohibited the sale of silver for gold on credit.”(Muslim)*

**Finance**

Nobody has doubt about the importance of finance for productive activities. Business owners may need funds to their businesses while investors have the desire to generate profits on their savings. Finance refers to capital contribution in a company through having a portion of the capital or buying capital shares.

Islam legalizes and regulates finance.

* Subject of finance

Money must be invested in productive activities.

*“except it be a trade” (An-Nisa 4 :29*)

* Method of finance

Finance must be in form of a company.

*“and lo! many partners” (Sad 38 :24)*

* Terms of finance

The company must be based on mutual consent and justice.

1. Mutual consent

*“except it be a trade by mutual consent” (An-Nisa 4 :29)*

1. Justice

*“and lo! many partners oppress one another, save such as believe and do good works, and they are few.” (Sad 38 :24)*

* Return to finance

The return to finance must be in form of sharing profit and loss.

*“whereas Allah permitteth trading and forbiddeth usury.” (Al-Baqara 2 : 275)*

In compliance with the Islamic rules;

* The government shall take necessary actions to prevent speculative activities, prohibited acts and impediments to the market freedom.
* Banks and lending institutions shall be transformed into investment banks.

Investment sectors

1. Private sector

Private sector includes those who invest in productive activities by themselves. They own and manage their businesses and they take full investment risk in environment of free competition.

1. Public sector

The main role of the government is to guide the country’s economic development by making broad decisions on economic priorities and policies. Government, also exercises executive control through directing its subordinate bodies in preparing and implementing the national economic plan which is based on the maximum and best utilization of available resources.

For the purpose of providing private investment opportunities, investments of the public sector shall be limited to the provision of goods and services that may not be rendered by the private sector for security reasons, such as defense, internal security, and foreign affairs, or because they are not profitable such as products needed for researches and protection of environment. Investments in public affairs shall be executed by specialized ministers, public organizations, or public banks

Initially, public entities and governmental administration bodies shall be financed by allocating a part of the available balances of the deposits with the branches of the monetary authority. In return, people shall pay for all public expenditures.

1. Banking sector

Banking sector represents privately owned and managed investment banks. Resources of each bank include:

1. Invested capital share of the owners of the bank (The shareholders).
2. Invested capital share of private investors who want to generate profits without being involved in direct investment. (The investors).
3. Invested capital share of the monetary authority. The capital share of the monetary authority includes:
* Part of the available balances of the deposits with its branches.
* Fair value or fair rent of public assets. Public assets include all assets which are not privately owned in addition to the natural resources and the public properties such as water, energy, and communication.

Each bank shall have a company relationship with investors as well as with the monetary authority. The company relation shall be based on profit and loss sharing contracts which translate fair terms and mutual consent of related parties. Compensations paid to the members of the board of directors and the top management personnel shall be considered as part of the profit share of the shareholders, while the running expenses shall be charged to the profit and loss account.

Banks shall invest in productive activities under control by the monetary authority for the interest of the whole society and according to the governmental plans.

Taking into consideration the advantages of competition and specialization, banks shall be divided into groups. Each group shall invest in a specific economic sector. Normally, profit margin differs from one sector to another. Agriculture does not give same return like communication. For giving equal investment opportunity to banks, the profit share shall be determined with consideration to the average return of the industry and the contribution to the growth of national product in all economic sectors in favor of the whole society. The capital share of the monetary authority in each bank shall be determined in the light of the public plans.

Banks shall not lend nor borrow money. They shall not be involved in transactions based on speculation, and shall not trade in stock markets. Banks shall not provide banking services. All receipts and payments of a bank shall go through the account of the bank with the monetary authority branch.

Banks may produce products, have them produced by others, buy them from others upon request of consumers, or buy them for resale or rent. They may invest in public services for future revenues. In addition to the direct involvement in production, banks shall provide capital-finance to private sector based on profit and loss sharing contracts.

Monetary authority shall control performance of banks, take necessary actions in order to avert financial corruption, and control prices of products provided by banks to prevent greed and unreasonable boosting of prices by private sector. To limit extravagance, high prices shall be set for luxury and harmful products such as jewelries, perfumes, cigarettes, five stars services of hotels and restaurants, and alcoholic drinks. From the viewpoint of the monetary authority, each bank is regarded as a project. Profit share of the monetary authority represents the main source of revenue in the government budget.

Finance products:

1. Consumer Finance

Banks shall provide credit facilities to professionals, business owners, consumers, and government through all types of credit sales, lease and rent. Banks shall sell real estates and cars on credit to consumers.

1. Business Finance

A bank, or a group of banks, may be engaged in a Profit and Loss Sharing Contract with other party or parties to establish a project, business, or trading deal. Other partner may be another bank, private business, public entity, or foreign investor bearing currency risk. Business finance initiates legal property rights over the equity of the subject project.

1. Domestic Finance Certificate

A bank, or a group of banks, may issue finance certificates in domestic currency in reasonably small face value. Investors shall buy the certificates based on a comprehensive presentation of the visibility study of the underlying project. Issuers and the investors shall form a company to establish the subject project based on sharing profit and loss. To help maximization of the return on investment, the certificates shall be issued on several stages according to the needed cash flow. Consideration shall be given to the investment period when calculating the profit or loss. The certificates shall be nationally marketable within the local stock markets. Separate financial reports shall be fairly disclosed. The certificates shall be redeemed by liquidation of the project. The domestic finance certificates provide investment opportunities to those who want to invest their money through others. Since investment projects are usually long term, the bank shall pay to the certificate holders regular advance payments of the expected profits subject to adjustment on final liquidation of the project.

1. Foreign Finance Certificates

The difference between the foreign finance certificates and the domestic finance certificates is that the first shall be issued in reasonably large denomination of a foreign currency and shall be internationally marketable within the local and international stock markets. The foreign finance certificates encourage foreign investments. The issuer shall bear the foreign exchange risk.

As an investment institution, each bank shall retain a completely separate set of accounting books and produce separate financial reports for each established company. Balance sheets of all companies shall be merged into the consolidated balance sheet of the bank. The account of the monetary authority with the bank represents the capital share of the monetary authority in the bank. The accounts of capital reflect the capital share of the shareholders. The accounts of the partners in the company books represent the capital share of the partners or the holders of the certificates.

All companies established by banks shall be based on sharing profit and loss. Having into consideration the variability of capital shares, fair distribution of profit requires that;

* The company’s contract shall determine, as percentage form the net profit, the profit share of each partner in return to his physical or mental contribution (if any).
* Profit shall be recognized on cash base only when it is actually received.
* Loss shall be recognized by liquidation of the company.
* On the date of recognition,

First;

Net Profit (if any) shall be reduced by the total of the equivalent amount of the profit shares for work. The amount allocated for work shall be distributed among the working partners according to the predetermined shares.

Second;

Considering variable capital company, balance of the net profit (or the loss) shall be distributed among the partners based on the daily balance of the invested capital share using the numbers calculation method.

The idea of the variable capital company was previously introduced in details as a new financing product in my book “Toward Islamic Bank” published in Arabic on 2004.

**Financial activities in present economies**

Even though economists share the same belief that the growth rate of national product is the indicator of how healthy is the economy; strategies are in conflict with the objective. Great portion of available funds are directed toward financial activities.

The excessive expansion of credit represents the prime reason for the rapid growth of lending and speculative activities. The desire of generating profit easily and quickly, the rapid growth of wealth of some individuals and corporations, and the growing inequality of income and wealth expedite the transformation into financial economy. Development of worldwide link between financial markets in response to globalization increases the volume of financial activities.

The historical review of financial crises briefly explain the destructive role of financial activities on societies and the failure of monetary remedies to prevent the ghastly impacts on economic growth. The excessive expansion of credit is responsible for the Wall Street Crash of 1929, the 2008 US Mortgage Crisis, the 1997 Asian Financial Crisis, 1998 Russian Financial crisis, and the Latin American Debt crisis.

In his article “The biggest financial crime in the history of the United States” addressed to the US citizen via Internet, Dr.Don J. Grundmann, D.C., M.H.says: “Since in 1996 approximately 40% of the United States budget went to the payment of interest on the national debt.”

Islamic Banking

The peculiar feature that distinguishes present Islamic banking from interest-based banking is that there is an asset underlying, directly or indirectly, each financing transaction. This feature gives more security for the investors and explains the reason for which Islamic banks were in better shape, relatively to traditional banks, when the 2008 World Financial Crisis hit the financial sectors worldwide. Having products as a base for Islamic finance does not mean that Islamic banking is in full conformity to the Islamic rules as stated in the Holy Qur’an and the sayings of the Prophet (Pbuh).

Islamic banks provide financial products in many different names. Murabaha, and Musharaka are the main financing instruments offered by Islamic banks.

* Murabaha

Instead of lending a customer to purchase an asset, an Islamic bank might buy the asset itself from the seller in cash, and immediately resell it at higher price to the customer who will pay the bank at a future date in a lump sum or in installments. This arrangement which is called “Murabaha” is based on opinions of some scholars, but some other scholars regarded Murabaha as a roundabout form of interest-based financing transaction.

Prophet Muhammad (Pbuh) prevents transactions of selling products which the seller does not possess or selling products in such a way where there is a doubt about its involvement in usury.

* Musharaka

Musharakah is a form of a partnership company based on profit and loss sharing contract where the bank and the customer provide capital to a business and the profit is distributed among the partners in pre-agreed ratios, while the loss is borne by each partner strictly in proportion to respective capital contribution.

For controlling purpose in banking business, all transactions related to the company activities have to go through an account retained by the bank. Normally, the customer pays his capital share in full at the establishment date of the company. The flow into the bank account shows fluctuated balances. This company account with the bank is similar to any other current account. In other words, the capital share of the bank, and maybe the capital share of other partners, is continuously fluctuating. As a result, the variable invested capital share of the bank does not comply with the terms of the company which are based on constant contracted capital shares. The difference between the contracted capital share and the real invested capital represents an act of capital withdrawal and is used by the bank in other activities not related to the company.

Fair distribution of profits requires that the profit should represent return to invested capital. The profit share must change in proportion to the change in the invested capital. Negligence of the capital fluctuation raises the usury issue and contradicts the terms of the company agreement.

*“O you who believe! Fulfill your obligations” (Al-Ma’idah, 5: 1)*

 *“And O my people Give full measure and weight in justice” (Hud, 11:85)*

*“and that when you judge between men, you judge with justice”(An-Nisa, 4: 58)*

**“***And, verily, many partners oppress one another, except those who believe and do righteous good deeds, and they are few” (Sad. 38: 24).*

CHAPTER 5

DISTRIBUTION OF WEALTH

The term distribution refers to the sharing of wealth among people. Growing unfair distribution of wealth causes concentration of wealth into few hands and has destructive impacts on societies; Rich becomes wealthier, middle class becomes poor and the living standard of poor declines, crime rate rises, and the state of harmony and cooperation between peoples is replaced by a state of hate, hostility, and envy.

The aim of a sound distributional policy is to ensure that every individual, old or young, disabled or healthy, male or female, enjoys, at least, a minimum standard of living.

**Islamic approach to distribution**

* God provides people with their living needs.

*“And how many an animal there is that beareth not its own provision! Allah provideth for it and for you. He is the Hearer, the Knower.” (Al-Ankaboot 29 :60).*

* Should provisions are supplied in abundance; people would rebel in the earth.

*“And if Allah were to enlarge the provision for His slaves they would surely rebel in the earth, but He sendeth down by measure as He willeth. Lo! He is Aware, a Seer of His bondmen.” (As-Shura 42 : 27).*

* Provision is not distributed equally among people.

*“Say (O Muhammad): Lo! my Lord enlargeth the provision for whom He will and narroweth it (for whom He will”) (Saba 34 : 36).*

* But people corrupt

*“Evil has appeared on land and sea because of what the hands of men have earned”*

*(Ar-Rum, 30:41)*

* People must redistribute wealth

*“in order that it may not become a fortune used by the rich among you”(Al-Hashr. 59:7).*

* The Holy Qur’an introduces the rules which people have to follow so that wealth can be fairly distributed among people*.* The rules of distribution are set in a form of rights and duties of individuals.

**Rights of individuals**

1. **Right of legal private property**

 *“Eat not up your property among yourselves unjustly”(An-Nisa’. 4:29)*

1. **Right of living means**

*“Verily, you have that you will never be hungry therein nor naked. And you will suffer not from thirst therein nor from the sun’s heat” (Taha, 20: 118-119)*

1. **Right of heirs (law of inheritance and bequest)**

*“There is a share for men and a share for women from what is left by parents and those nearest related, whether the property be small or large – a legal share”(An-Nisa, 4:7)*

Many verses of the Holy Qur’an show the distribution rules of an estate among different heirs.

**Duties of individuals**

1. **Duty of work**

*“And say (unto them): Act! Allah will behold your actions, and (so will) His messenger and the believers,” (Al-Tawba 9 : 105).*

Limits of duty of work

 *“Allah burdens not a person beyond his scope” (Al-Baqarah. 2:286)*

1. **Duty of paying for products**

*“There is nothing for man but what he strives for”(An-Najm, 53:39)*

1. **Duty of personal spending**
	* For personal living

*“And surely, We gave you authority on the earth and appointed for you therein provisions”(Al-A’raf, 7:10)*

* + For the living of the wife

*“Men are the protectors and maintainers of women … because they spend from their means”(An-Nisa, 4 : 34)*

* + For the living of the family

*“They ask you what they should spend Say: Whatever you spend of good must be for parents and kindred and orphans and the poor and the wayfarer”(Al-Baqarah, 2: 215)*

Limits of spending for living

* **Without miserliness**

*“Those who are miserly and enjoin miserliness on other men and hide what Allah has bestowed upon them of his Bounties. And We have prepared for the disbelievers a disgraceful torment.” (An-Nisa’. 4:37)*

* **Without extravagance**

 *“and waste not by extravagance“ (Al-An’am. 6:141)*

* **Within financial capacity**

*“There is no blame on those who are weak or ill or who find no resources to spend”*

*(Al-Taubah, 9:91)*

1. **Duty of spending in favor of the society**
* **Rights of others**

*“An in their properties there was the right of the beggars and the poor”*

*(Adh-Dhariyat, 51: 19)*

* **Rights of the community**

*“Spend your wealth for the cause of Allah” (Al-Baqara 2:195)*

Methods of spending for the society

* **Duty of Zakat (Wealth tax)**

*“Take Sadaqah from their wealth in order to purify them and sanctify them with it”*

*(Al-Taubah. 9:103)*

*“The alms are only for the poor and the needy, and those who collect them, and those whose hearts are to be reconciled, and to free the captives and the debtors, and for the cause of Allah, and (for) the wayfarer; a duty imposed by Allah.”*

*(Al-Tawba 9 : 6)*

The word “Sadaqah” in this verse refers to the “Zakat” which is a duty imposed on wealthy people only. Zakat is regarded as wealth protection duty. It protects rich from the poor’s reactions of envy and hate. It also purifies the human soul of vices like greed and selfishness. Zakat is an obligatory tax allocated for distribution among the needy to meet their right of living means.

* **Duty of charities and alms**

*“As for him who giveth and is dutiful (toward Allah) And believeth in goodness; Surely We will ease his way unto the state of ease” (Al-Lail 92 : 5-7)*

*“If ye publish your almsgiving, it is well, but if ye hide it and give it to the poor, it will be better for you” (Al-Baqara 2 : 271)*

* **Duty of fighting by properties**

*“Go forth, light-armed and heavy-armed, and strive with your wealth and your lives in the way of Allah” (Al-Taubah, 9:4)*

*“Verily, Allah has purchased of the believers their lives and their properties for that theirs shall be the paradise. They fight in Allah’s Cause”(Al-Taubah, 9:111)*

* **Duty of spending for good deeds**

*“And spend in the cause of Allah ..” (Al-Baqarah, 2:195)*

Limits of spending for society:

* **Within financial capacity**

*“Let the rich man spend according to his means; and the man whose resources are restricted, let him spend according to what Allah has given him. Allah puts no burden on any person beyond what He has given him”(At-Talaq, 65 :7)*

*"And We ask not any person except according to his capacity” (Al-Muminun, 23:62)*

* **Up to full financial capacity**

 *“And they ask you what they ought to spend. Say: that which is beyond your needs”*

*(Al-Baqarah, 2:219)*

In brief, Islamic rules of distribution require that every person has the right of living means. In return, every person must pay for his needs (Nothing for free) and must spend for the society within the excess of his wealth over his needs.

Realization of the minimum standard of living requires that every individual can afford paying for the cost of living. Cost of living includes:

1. Cost of living necessities

Cost of living necessities represents the fairly estimated cost of all items that is considered necessary for personal living such as housing, food, drink, clothing, communication, transportation, and utilities.

1. Cost of personal services

Cost of personal services represents the reasonably predetermined premium which shall be paid by every person to obtain standard quality of personal services such as health care, medication, education, comprehensive property and accident insurance, emergency services, infrastructure services, sport facilities. Rich shall pay the price difference to obtain private services of higher quality.

1. Cost of public services

Cost of public services represents the fairly determined fee which shall be paid by every person to cover public expenditures in return for public services such as defense, internal security, researches, and environment protection.

Cost of living differs according to the age of the individual and the living standard in the community. Cost of living shall be amended relatively to the changes in the cost of its components. Rules shall be issued to fairly consider cases of orphans living in a family in order to protect privacy of their wealth.

*“And give unto orphans their property and do not exchange your bad things for their good ones; and devour not their substance by adding it to your substance. Surely, this is a great sin.”*

*(An-Nisa, 4:2).*

Living limit refers to the total amount of the cost of living for the individual and his dependents. Every person shall be liable to pay, in regular base, the cost of personal and public services for himself and for his dependants. In return, the government shall be responsible for the full recovery of the shortage of the personal wealth to reach the living limit.

For recovery purposes, the profit share of the monetary authority, which represents the return to its investments through the banking sector, shall be considered as the primary source of revenue. In case of insufficient profit, the difference shall be collected by the government through imposing a wealth tax on rich people.

Wealth tax shall be levied on the excess in the individual’s wealth over his living limit. Individual’s wealth includes his income during a year in addition to the net fair value of the fixed and current assets which can be used to generate profits as at the beginning of the year. Assets include investment certificates and stocks, but do not include balances at monetary authority because such balances do not represent wealth.

Wealth tax shall be calculated at fixed or progressive rate on the personal wealth as at the end of every year and shall be collected by the government on regular payments within the following year. The Prophet (Pbuh) applied Zakat on camels, cows, sheep, and agriculture products and collected after a lapse of one year. The Prophet (Pbuh) did not levy Zakat on debts. Unlike old money, recent money represents legal rights guaranteed by the government.

The following table illustrates the difference between income tax and wealth tax paid by four different persons (A, B, C, and D) with same number of dependents.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Details** | **A** | **B** | **C** | **D** | **Total** |
| **Wealth Tax** |  |  |  |  |  |
| Net wealth at beg. of the year | 11,000 | 2,500 | 35,000 | 220,000 | 268,500 |
| + Net income during the year | 10,000 | 20,000 | 50,000 | 5,000 | 85,000 |
| = Wealth at end of the year | 21,000 | 22,500 | 85,000 | 225,000 | 353,500 |
| - Living limit | 25,000- | 25,000- | 25,000- | 25,000- |  |
| = Net wealth subject to wealth tax  | 4,000- | 2,500- | 60,000 | 200,000 |  |
| 2.5% Wealth tax | **0** | **0** | **1,500** | **5,000** | **6,500** |
| Spending on wealth recovery | **4,000** | **2,500** |  |  | **6,500** |
| **Income Tax** |  |  |  |  |  |
| Income during the year | 10,000 | 20,000 | 50,000 | 5,000 | 85,000 |
| - Tax exemption | 10,000- | 10,000- | 10,000- | 10,000- |  |
| = Net income subject to income tax  | 0 | 10,000 | 40,000 | 5,000- |  |
| 20% Income tax | **0** | **2,000** | **8,000** | **0** | **10,000** |
| Spending on social and public services |  |  |  |  | **10,000** |

Additional wealth tax may be levied to finance requirements of emergency cases such as war and natural catastrophes. The additional amount of wealth tax may extend to absorb all the surplus wealth over the living limit. In case of insufficient tax, all people ought to share responsibility through a decline in the amount considered as living limit.

Wealth tax will help fair distribution of wealth. It will not cause inflation because it is not an element of the cost of products. Wealth recovery will ensure fair living standard for all people. It will replace present welfare systems, obligatory social security contributions, and governmental retirement programs.

Effective controls shall be set by the government to prevent dependency on wealth recovery. Maximum utilization of available resources together with good planning is the best way to secure sufficient employment opportunities.

**Distribution in present economic systems**

A country may be growing richer in the sense of growth in total output without the people in the country growing any richer as individuals, The growth in output per capita does not fairly determine the growth in output available for each member of the society.

In its attempts to solve poverty problems, government adopts some welfare systems. Welfare systems include all forms of public assistance, such as unemployment compensation, housing, food stamps, free services, subsidies and cash aid. Assistance and subsidies represent a sort of giving alms to poor. Present welfare systems increase public expenditures. Social security and retirement systems increase labor cost. In general present socioeconomic systems result in inflation. Socialism failed to realize its objective of equality because labors lose their incentive for work and resources are managed by bureaucracy.

Inequality in distribution of income among people as a result of the different contribution in the production process is a natural phenomenon as long as people have different capacities.

Inequality which is responsible for the unfair distribution of wealth refers to the special advantages legally given to a group of individuals or corporations so that they can increase their share of the national income. Present economic systems legalize many forms of such advantages;

* Borrowing opportunity

Banks and financial institutions, normally, do not grant credits unless they get sufficient collaterals from borrowers. Required collaterals are available with rich people who can use such credits to increase their wealth, and in turn, getting more credits, increasing more and more their wealth. In the contrary, very limited borrowing facilities may be provided to small businesses and professionals.

* Suppliers’ gains

Financing charges in addition to taxes paid by suppliers and labors are charged to consumers in form of price increase. Consumers do not have similar possibility to charge their payments of taxes and financing charges to somebody else. In general, Owners of businesses are richer than employed people.

* Inflation

Inflation raises value of assets. Most of assets are owned by rich while few assets are owned by middle class and poor.

* Monopoly

In the absence of competition, monopolists can raise prices.

* Feudalism

Feudalism gives advantage to a tiny group of people of the upper class to own the land and capital while others work as servants or slaves.

* Credit money

As a result of the money creation process, banks have an advantage to accumulate interest received as return to the repetition of lending a specific amount of deposit.

* Democratic capitalism

Based on its definition as a form of government in which the sovereign power is vested in the people and exercised by their elected representatives, democracy is introduced as the ideal method for people to direct policies in favor of the society. In realty, democracy is merged into monopoly capitalism to concentrate both authority and power among rich so that a tiny group of oligopolists dominate both economy and policy through direct involvement in the ruling system or as a return for their spending on the election campaigns.

A simple analysis of the remedies for the 2008 U.S. mortgage crisis illustrates how the rich govern the decisions of governments in democratic capitalism. The problem is that the mortgage loans are in default. The excessive and imprudent expansion of credit was the reason of the problem. Many governments were in a hurry to pour liquidity into financial systems so that financial entities can meet requirements of cash flows. They claim this action is necessary to protect depositors and encourage credit expansion to help stability of markets. The solution is based again on excessive expansion of credit and represents a reward to those who created the problem. In addition to the huge profits which financial institutions generated in previous years, public money is used to bail them out of the crisis. Better results could be achieved through direct support to borrowers by rescheduling mortgage loans based on lower payments and interest.

CHAPTER 6

FEATURES OF ISLAMIC ECONOMIC SYSTEM

Each economic system has its own peculiar features which form its foundation and from which it can be distinguished and recognized. The most dominant economic systems in the modern world at present are capitalism and socialism.

**Capitalism and Socialism**

In theory, capitalism is an economic system which is characterized by private ownership of the means of production and unrestricted economic freedom. In practice, capitalism has been transformed into the recent monopoly-finance capitalism where a tiny group of people dominates economic policies and invests savings of people in financial and speculative activities leading the world to regional and global financial crises.

Socialism denotes an economic system of state ownership and/or worker ownership of the means of production and distribution. Abolishment of the rights of private ownership and economic freedom leads to management of means of production by the bureaucracy. Bureaucracy results into inefficiency and low production since the money incentive is lost and the bureaucrats lack initiative and follow rigid rules.

In spite of the fact that each of present economic systems has its own features, they share same common characters. Present economic systems consider inflation as a natural phenomenon and introduce money as the heart of the economy and credit as its backbone. Financial and speculative activities represent majority of economic activities. The institution of interest has become the major part of the present systems. Corruption has become a complex and generalized phenomenon all over the world. Rights of living means are regarded as an issue of social aids. Freedom of the market is not respected. Present economic systems failed to realize prosperity; instead, rates of hunger and poverty accelerate rapidly.

*“Evil has appeared on land and sea because of what the hands of men have earned (by oppression and evil deeds), that He (Allah) may make them taste a part of that which they have done, in order that they may return.”.*

*(Ar-Rum, 30:41).*

**Islamic Economic System in practice**

In their efforts to practice Islamic economic rules, some Islamic countries; such as Iran, consider the prohibition of usury, but they imitate traditional economic measures. This does not mean that their economic system is in full compliance with Islamic concepts as presented by the Holy Qur’an and the Sunnah;

1. Considering monetary policy as the tool for government to pursuit economic objectives.

The monetary authority uses profit rate and Musharaka certificates as a substitute tool for interest rate and treasury bills. By determining the profit share of depositors, the profit share of banks, or the volume of Musharaka certificates available in the market, the central bank controls money supply. Targeted quantity of money supply is determined by the government. Government changes money supply to the extent which the economic officials think they may reach an adequate expansion of money supply to assist economic growth and achieve their economic goals.

* In productive economy, production determines quantity of money. Production, not the government, controls quantity of money. Government must change the quantity of money relatively to the change in production, so that to ensure stability of the value of the currency unit. Changes in quantity of money which is not in accordance with the changes in production constitute an intervention into the natural market system which is set by God.
1. Reducing income inequality is regarded as one of the central goals of economic policies.

The system defines certain instrument as means of promoting social justice. Price regulation policies, reforming salary payment system, extension of the social security and insurance system, control of population, and reforming of the tax system are some examples of the remedy tools used to carry out the distributional policies.

* Reducing income inequality is not a goal of the Islamic economic system. The Holy Qur’an recognizes the differential in wealth. The objective of the distributional policy in Islam is that everyone must have the means of living. Zakat is presented as the obligatory way to achieve this objective. The government role is to implement Zakat. For the purpose of distributing wealth, government should not introduce methods other than those mentioned in the Holy Qur’an.

Islamic economic system has been set by God. It is a self-correcting system. Government intervention into the system is forbidden. The government role is to govern by what God has revealed.

*“And so judge among them by what Allah has revealed and follow not their vain desires”*

*(Al-Ma’idah, 5:49)*

*“We have neglected nothing in the book”(Al-An’am, 6:38)*

**Islamic Economic System**

The Islamic economic system which is based on Islamic rules, as introduced by the Holy Qur’an and the Sunnah, has its unique features. It is based on productive economy where is no room for usury, speculative activities, or man-made inflation. It is an integrated system where production controls money. It is self-correcting system where prices are determined by the free natural market. It considers the complex requirements and the accelerated technological improvements. The interest of society is given priority. Private property is protected. The right of all people to acquire means of fair standard of living is fully respected. The role of the government is to provide financial security and justice, and to ensure maximum and best utilization of resources and appropriate implementation of the system.

*“Holy Prophet is reported to have said: The government is the guardian of anyone who has no other guardian.”(Abu Daud, Tirmizi)*

In Smith's view, the ideal economy is a self-regulating market system that automatically satisfies the economic needs of the populace.

**Conclusion**

The views expressed here are undoubtedly drastically different from the views held by economists and other researchers in Islamic economy.

*“If ye differ in anything among yourselves, refer it to God and His Messenger” (Al-Nisa 4 : 59).*

*“Whatever it be wherein ye differ, the decision thereof is with Allah” (Al-Shura 42 : 10).*

Financial distress is increasing and people will, sooner or later, realize the truth and make concert efforts to gradually embrace an alternative system that would reflect fair economy. No doubt that an economic system based on rules set by God is the best for all people.

***All praise is due to God alone, the Sustainer of all the worlds***