

# **GUIDELINES FOR KEY ISSUES IN ISLAMIC ECONOMICS**



**International Center for Research in Islamic Economics  
King Abdulaziz University  
Jeddah – Saudi Arabia**

**1405 – 1985**



Research Series in English No. 21  
(Discussion Paper)

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**INTERNATIONAL CENTRE FOR RESEARCH IN  
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Verily with Allah is the ultimate reward.

**Omar Zohair Hafiz**  
Director

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# **GUIDELINES FOR KEY ISSUES IN ISLAMIC ECONOMICS\***

## **1. INTRODUCTION : Objectives and Assumptions.**

The main objective of this paper is to highlight the Islamic synthesis of the predominant view in respect of some key issues in Islamic economics. It would be designed in a way so that some policy guidelines can be derived as well as conclusions drawn. This outline is expected to facilitate either further theoretical development of Islamic economics as a science or to provide a structure of analysis from which an operational policy package may be evolved.

This paper is written on the assumption that the reader has some elementary knowledge of economics as well as some knowledge of the *Shari'ah* (Islamic jurisprudence). As such, the relevant verses of the Qur'ān or Hadith have not been reproduced, although every effort is made to record faithfully the essence of the *Shari'ah* and its spirit to elucidate the Islamic position in respect of the issues involved. At this stage it is perhaps desirable to have an overview of Islamic socio-economic philosophy, so that an integrated view of Individual-Society-State relationship is properly understood.

## **2. ISLAMIC SOCIO-ECONOMIC PHILOSOPHY : An Overview.**

### **The integrated nature of Individual-Society-State relationship in Islam.**

A critique of Islamic thought patterns will reveal that different aspects of Islamic social framework have been united into one whole by their axiological, existential base – the principle of “*Tawhīd*” (oneness of Allāh) which owes its origin from the repeated Qur'ānic teaching of Oneness of Allāh. Such unitary character is found in all dimensions of Muslim socio-structural order, system of knowledge and metaphysics. Islamic economic issues are simply a part of the integrated whole. Whatever may be the nature of investigations of the Qur'ān and the Sunnah, there is practically no differences of opinion as regards integrated overall-view of life and society. The social philosophy, owing to the unitary character of Islam, knows no distinction between a spiritual and a temporal realm nor between religious and secular activities in the society. The whole range of man – society and man – state relationship is to be understood against the background of this social philosophical thought of Islam.

\* This paper is mainly based on M.A. Mannan's two books entitled: *Islamic Economics: Theory and Practice*, Sh. Mohammad Ashraf Publications, Lahore, Pakistan, 1970 and *The Making of Islamic Economic Society: Islamic Dimensions in Economic Analysis*, International Institute of Islamic Banking and Economics, Kibris (Turkish Cyprus), 1984. Initial notes on the subject prepared by Dr. M. Fahim Khan and other scholars of the Centre were helpful. The paper was presented by Dr. M.A. Mannan at the Joint International Conference on Research in Crime Prevention sponsored by Arab Security Studies Centre and United Nations Social Defence Research Institute, Rome held in Riyadh, 23-25 January, 1984.

Society or State in Islam is for the individual who is responsible for his actions and accountable to Allāh for his conduct. It is evident that Allāh could not possibly have made the individual accountable for his conduct if everything in his life was determined by the forces external to him. This notion of accountability gives him freedom to participate in the construction of the society in which he belongs as well as puts restriction on him not to degrade the society Islamically. In an Islamic state, the individual is seen as an integral part of his own family, his community, his State and the international community at large. Therefore, he has some economic and social responsibilities towards each of the components of his integrated life.

Now the question arises as to where individual freedom ends and social control begins. As a matter of fact this social control guarantees individual freedom as it enables the individual to perform his duties as prescribed by the *Shari'ah*. Therefore, freedom and control are not contradictory but complementary to each other, because it is control which protects the freedom and vice versa. It is the essence of Islamic concept of freedom and control. What is important then is to describe the operational limits of altruistic behaviour of individuals in a particular social and economic context. The social authority in the form of the State which is recognized by Islam for the prevention of exploitation and moral degeneration as well as for promotion of material and spiritual interest of man is to be understood from this angle of social vision.

Thus a purposive relationship based on good-will and co-operation is found in the Individual-Society-State relationship. It is the state which enforces the Islamic law and makes individuals fulfil their obligations towards society but it is the individuals who select their rulers to enforce the *Shari'ah*. The rulers cease to deserve obedience, should they transgress the *Shari'ah*. These checks and balances are found in all dimensions of Islamic social framework which can be expressed in terms of moral, social, economic and political dimensions.

In the moral sphere Islamic faith is essentially a unity. It is at once worship and work; secular conduct of life is not divorced from religious beliefs of Muslims. In social sphere its distinguishing feature lies in its complete human equality, just and coherent unity of existence and mutual responsibility of individuals and societies in Islamic scheme of things, nobody would be allowed to exploit the other; everybody should be given equal opportunity to go up the social ladder. This is operational not only through the institution of prayers in the mosques but also through acquisition of wealth and property.

The economic dimension is manifested through emphasis on the distributive justice and beneficent use of the "bounty" of Allāh. According to the Qur'ān, all resources of the universe belong to none but Allāh. This concept of absolute ownership by Allāh promotes re-distribution of wealth among have-nots and also creates a non-capitalist frame of mind. Individual owner-



ship has been recognised to provide incentive to work but the state has even the right to deprive the ownership of property in extreme cases if it is remained unused or used against the interest of the community. Lastly, the political dimension of Islamic social framework can be expressed in terms of three fundamental conceptions: sovereignty of Allāh, equality of mankind and the principle of co-existence.

The main conclusion which emerges from the preceding discussion is that the integrated model of Islamic social framework of which Islamic economics is a part, is among others, based on the following nine criteria:

- (a) fair balance between worship and work;
- (b) human equality;
- (c) mutual responsibilities and co-operation in a society;
- (d) distributive justice
- (e) family, intra-family and collective obligations carrying individual responsibilities and accountability;
- (f) balanced and beneficent use of the “bounty of Allāh”;
- (g) limited sovereignty of people in society;
- (h) principle of co-existence and
- (i) freedom of action and conscience.

These criteria on which Islamic social framework is based are co-ordinated and integrated so that they provide a positive motivation for economic activities, steered by the concept of fair balance between material and spiritual needs and between private and social needs.

### **3. ISLAMIC KEY THRUST IN SELECTED MICRO ISSUES**

Let us now take up a few Key micro-issues recognised in all economic system irrespective of their ideological bias in one way or other. The list of issues discussed in the succeeding paragraphs is in no way exhaustive, nor is it intended to be. Nevertheless they would provide a direction in understanding micro-economics of Islam.

#### **3(a) Private Ownership: *Its Principles.***

Islam recognises private ownership of property. This ownership is relative, not absolute. For, the Qur’ān categorically states that absolute ownership belongs to Allāh alone. The state can intervene if individual misuses his ownership of property and causes harm to the society. This is a predominant Islamic position on the concept of private property in Islam. Although there is a consensus as regards the intervention of Islamic state, opinions differ on the question of the extent of such intervention. There is in fact no hard and fast rule in this regard, although state intervention can be reduced to a bare minimum, when individual discharges his Islamic obligations voluntarily. In its final analysis, it depends on Islamically justified social awareness of the individual as well as the nature and the state of the economies and their concerned institutions.

However, from a careful study of the *Shari'ah*, it should be possible to derive at least the following eight rules governing private ownership of property:

1. Continuous use of property as non-use of property is not allowed having implications for land reform in many Muslim countries.
2. Payment of *Zakāh* : Owner of the property must pay *Zakāh* in proportion to property owned subject to the rules of the *Shari'ah*. rules of the *Shari'ah*.
3. Beneficent use of property.
4. Use of property without causing any harm to others having implications for state intervention.
5. Lawful possession of property; acquisition of property through "*halāl*" means.
6. Balanced use of property: use of property not in a prodigal or parsimonious way.
7. Use of property for the purpose of securing for himself due benefits; utilisation of property for securing undue benefits in social, economic affairs to the neglect of the larger interest of the community is not permissible.
8. Rightful application of the law of inheritance, as the institutions of inheritance seeks to break up concentration of wealth and income that occurs through transfer of property in the secular economies.

The above mentioned basic rules governing the Islamic concept of private ownership have profound economic and social implications for contemporary Muslim societies particularly in countries where land tenure system is still linked to the colonial legacy. From the preceding discussion it is also evident that private ownership contains an element of public share. As such there is no pure form of private ownership as found under secular economies.

### **3(b) Land as a Factor of Production.**

Islam has recognised land as a factor of production. In classical writings, land includes not only the surface of the earth but also all natural and mineral resources and other free gifts of nature. There is no evidence to prove that Islam does not approve this definition of land. But the way Islam looks upon land as a factor of production has its own distinctiveness which can be expressed in terms of productivity and distributive justice and inter-generational obligation. Thus the utilisation and maintenance of land as a factor of production can be seen at least from three ways within the framework of an Islamic economic society:

- ( i ) Land in the process of cultivation;
- (ii) Land as natural resources; and
- (iii) Land as exhaustible existence.

*(i) Land in the process of cultivation.*

Both the Qur'ān and the Sunnah have laid down much emphasis on the proper cultivation of the land. The Qur'ān has categorically drawn attention of Muslims to make use of the wasteland by turning it into garden by making appropriate arrangement for watering it and growing good crops. This emphasis on increased agricultural production is significant in case of many Muslim countries which are not yet self-sufficient in food production. This is also significant in case of those countries where most of the land belongs to non-cultivator owners or where the distribution of land is inequitable giving rise to emergence of a class of landless labour. Because the Prophet (be peace on him) tried to impress upon his followers to cultivate land by themselves. For, it is expected to ensure proper and efficient cultivation of land. Wastage of land in any form is condemned. But cultivation of land should not be the only occupation of the people in an Islamic State. The State can make rules to ensure that land as a factor of production is used in such a way that the objective of the balanced growth is achieved for the benefit of the community.

*(ii) Land as Natural Resource.*

A Muslim can acquire ownership of the natural resources after fulfilling his obligations towards his society. The use and maintenance of the natural resources can give rise two components of earnings. These are: (a) earning from natural resources on its own right (i.e. pure economic rent) and (b) earning from the improvement in the use of natural resources through human labour and capital; while the pure economic rent must be shared equally by all members of the community, one is entitled to proper compensation for human effort (i.e. wage and profit). It is therefore important to separate pure economic return from other factor compensation resulting from the use of natural resources.

*(iii) Land as Exhaustible Resource.*

It is an Islamic viewpoint that exhaustible resource belongs to the present as well as future generations. The present generation have no right to misuse the exhaustible resources now which may cause harm to the future generations.

From the above analysis, the following hypothesis or policy guidelines can be derived:

- (a) The agricultural development in Muslim countries can be accelerated through intensive and extensive method of cultivation if it is supplemented by a programme of moral education.
- (b) The revenues generated from the use of exhaustible resources should be spent more on the development of social overhead (i.e. university, hospital) and physical infra-structure rather than current consumption.

- (c) The pure economic rent may be spent more to meet current consumption expenditure.

### **3(c) Labour as a Factor of Production.**

Labour as a factor of production is recognised in all economic systems irrespective of their ideological bias. Nevertheless the distinctive nature of this factor of production in Islam is due to the fact that labour, for that matter all factors of production, is not merely subject to a process of historical change as we find in the case of modern secular economics but also to a timeless moral and ethical framework under which all factors of production operate.

It is true that a modern worker has a property in his hand – labour which he is entitled to sell for as much as he can get, but in Islam he is not absolutely free to do what he wants to do with his own labour. Normally he is not allowed to adopt the profession not permissible in the *Shari'ah*. Thus we see that in Islam, labour is used in a wider and restricted sense. It is wider, because it looks upon the labour services beyond pure monetary services; it is restricted because, he is not absolutely free whatever he wants to do with his own labour. Besides Islam provides a comprehensive moral code of conduct which is expected to influence his work ethics. It is indeed a religious obligation that a labourer works sincerely and performs the task, assigned to him efficiently and honestly. This built-in psychological motivation can raise labour productivity and reduce labour alienation, if labourers are imbued with the Islamic values through appropriate training programmes. This brings us to discussion on capital as a factor of production.

### **3(d) Capital as a Factor of Production.**

The Islamic economic system must be free of interest. But capital is not costless in Islam despite the fact that interest is prohibited. The cost of capital can be expressed in terms of opportunity cost in an Islamic framework. Therefore, the rate of return in a particular economic enterprise can be used as one of the allocative devices for capital. Islam does recognise the share of capital – a share which is variable. Thus, it is because of the presence of the element of profit that capital can grow even in the interest-free economy of Islam. Various injunctions of the Qur'an go to prove that Islam can bring about a compromise between two opposites of capital creation: reduced current consumption and increased future consumption, thereby allowing capital to play its true role in the productive process as Islamic economy is essentially equity-based rather than loan-based. The ideal alternative to interest is profit and loss sharing. In Islam profit is distributed according to the condition agreed upon but the loss is to be borne by the financier.

### **3(e) Consumption Behaviour.**

The Islamic injunctions on food and the order of priority in consumption should provide us some interesting insights to understand the nature of con-

sumer's behaviour in Islam. In course of analysing the consumer's behaviour one may take a narrow and static view by saying that consumer's behaviour in an Islamic society is to be guided strictly by the list of prohibited items (i.e. eating pork meat, drinking wine, wearing silken dress and gold ring for men, etc.). While the prohibited items have definite validity in the *Shari'ah* and Muslim consumers must not indulge in consumption of such prohibited items for social discipline, Islamic unity and spiritual significance, the author is however inclined to take a wider view of consumer's behaviour. To me, the key to its understanding lies not merely in prohibited items but in the concept of "moderation" in consumption guided by the altruistic behaviour of Muslim consumer. What is needed then is to determine whether the current consumption level in a community is below or above the moderation level. In the context of present Muslim societies, it would be naive to assume that Islamic stress on moderation means lowering the level of already low level of consumption.

Consumption is essentially a positive concept in Islam. The prohibitions and injunctions concerning food and drinks should be seen as a part of the efforts to improve the quality of consumption behaviour. By discouraging wasteful and unnecessary consumption expenditure, Islam stresses on the altruistic behaviour on the part of the consumer. Moderation in consumption behaviour comes then as a logical outcome of Islamic consumption style which is relative and dynamic in nature.

### **3(f) Distribution.**

It is on the issue of distribution of national income that the widest controversy has been and is still going on between different sections of the people of democratic society. Since the economic welfare of the masses depends vitally upon the manner in which the total national income is distributed among the people, common sense suggests that the theory of distribution should deal with the problem of distribution of national income among different classes of people. In particular, it should be in a position to explain the phenomenon that a few are very rich, while the great many are poor. But the tradition among modern economists is to treat the distribution problem not as a problem of personal distribution but as a problem of functional distribution. "The modern economic theory of distribution is a theory of pricing of productive service. It seeks to find out the value of the service of different factors of production. In this respect, the distribution theory is but an extension of the general theory of pricing. The problem of personal distribution can, perhaps, best be solved as soon as we investigate into the problem of ownership of factors of production. The theory of factorial or functional distribution helps us to determine the prices of the services rendered by the different factors of production, such as land, labour, capital and organisation". But under a market economy a person may get rent. As a labourer, he may get wages. As a capitalist, he may earn interest. As an entrepreneur, he may also be the reci-

ipient of profit. In Islamic economics, we are concerned with both personal distribution as well as functional distribution.

### ***On Functional Distribution***

As regards functional distribution, Islam recognises rent (i.e., earning of land), wages, (i.e., earning of labour), profit (i.e., earning of capital and entrepreneur). In the first instance, the payment of rent which generally refers to the conception of “surplus” earned by a particular unit of a factor of production in excess of the minimum amount necessary to keep that factor in its present occupation, does not seem to be inconsistent with the spirit of Islam. Secondly, wage differences resulting from differences in talents and capacities have been recognised by Islam. The fundamental conditions are that employers shall not exploit their labourers and must pay their “dues” and the workers shall not exploit their employers through trade unions and must do their job faithfully, sincerely and honestly. While there is a general consensus regarding the need to pay the workers’ “dues”, opinion differs as to whether this “dues” is to be determined according to his “marginal product”. Thirdly, the Islamic theory of capital does recognise the share of capital in national wealth only to the extent of its contribution, to be determined as a variable percentage of profits rather than the fixed percentage of capital itself which is interest. It is prohibited in an Islamic economy, because interest is responsible for the growth of Capitalism with all its attendant evils in society: it creates the problem of unemployment; it retards the process of recovery of depression; it aggravates the debt-servicing problem of the underdeveloped countries; finally, it uproots the basic principles of co-operation and mutual help and creates in man selfishness. The so-called allocative function claimed to be performed by interest rate in a market economy can be done by expected rate of return (i.e., derived from opportunity cost concept) in an Islamic economy. Fourthly, Islam has allowed normal profit – not monopoly profit or profit arising out of speculation which is not generally permissible in Islam.

### ***On Personal Distribution***

The *Shari'ah* provides a comprehensive framework for ensuring distributive justice including the impact of the prohibition of interest not only on productive loans but also on consumption loan. The main objectives of distributive measures are:

- (a) to make provisioning for minimum level of living through fulfilment of basic needs, thereby reducing inequality;
- (b) to foster social cohesion and co-operative spirit;
- (c) to increase efficiency and producing positive climate for mutual help and involved participation.

It follows that in an Islamic economy, a given distribution of income and wealth will be acceptable only when the society is in a position of provide a

guarantee of a minimum level of living to its each member as defined in accordance with the *Shari'ah* and socio-economic realities as well as there is a sustained effort to defuse the concentration of ownership of the means of production and wealth, thereby reducing both relative and absolute disparities of income and wealth.

### ***Distributive Measures***

A number of operational policy packages having far-reaching implications to reduce disparities of income and wealth may be evolved through the implementation of the Islamically justified obligatory and voluntary distributive measures which include:

1. payment of *Zakāh* and *Ushr*;
2. prohibition of *Riba* on both consumption and productive loans;
3. entitlement of pure economic rent (i.e., income earned without any special effort by anyone) to all members of the community or to the state;
4. implementation of laws of inheritance to ensure equitable inter-generational transfer of property;
5. encouragement to give benevolent loan free of interest (i.e., *Qard-Hasan*);
6. discouragement to deplete exhaustible resources by the present generation to the disadvantage of all future generations;
7. encouragement to pay *Ṣadaqah* (charity) to the poor by those who have “surplus” funds beyond their needs);
8. encouragement to organise co-operative insurance;
9. encouragement to set up philanthropic trusts (i.e., *Awqāf*) in providing social goods, as well as private goods to deserving individual;
10. encouragement to lend the productive asset *without* charge to those who are in need of it, the recipients are expected to return it to its original owners; after accomplishing the objective for which it was taken (i.e., *Maa'un*);
11. legal measures against the public treasury to enforce the guaranteed minimum level of living, once defined by an Islamic state in accordance with the *Shari'ah* as well as socio-economic realities;
12. provisioning of additional “taxes” beyond *Zakāh* and *Ushr* (one tenth of the agricultural produce) by an Islamic state to ensure distributive justice.

### **3(g) Market Mechanism and Islamic Policy Alternatives.**

The free-market mechanism is based on effective demand, making resources available to those who can buy them not necessarily to those who need them. As such in an Islamic economy, price offered by the market can not be accepted as a matter of rule. Competition as implicit in the market mechanism needs to be supplemented by conscious control, supervision and co-operation. This is where Islam enters. The key lies in mutual good-will and

co-operation, while the market prices emerge from the wholly unsupervised interaction of competing buyers and sellers. *Islamic equitable price* need to emerge from the supervised competition, conscious control and co-operative interaction of the buyers and sellers.

The drive to maximise profits as seen under the market economy is not merely an economic phenomenon: it is also the psychological as well as social phenomenon. It is the social mechanism and economic institution which create the necessary conditions to work in one way or another.

### ***Three Policy Options***

Now it can be said that an Islamic economy may face the following three policy options:–

- (a) to eliminate the market mechanism and control price;
- (b) to allow the market mechanism to operate freely; make direct transfer payments to the poor so that they can enter into the market; and
- (c) to allow the market mechanism to operate through necessary control and corrective measures practically in providing basic needs to the community not necessarily in providing goods and services beyond the basic needs.

Option (a) is clearly not permissible in Islam, as it is against the principle of basic economic freedom of the individual which Islam seeks to preserve. The economic compulsion can be applied in an Islamic society only as a special case in order to strengthen the collective social and economic responsibility of the individual members.

Option (b) is also not acceptable to the author for several reasons: Firstly, it is based on the implicit assumption that the market mechanism will automatically ensure equitable re-distribution of goods and services through invisible forces of demand and supply. Here reality is far from this theoretical possibility. Secondly, the market is either inefficient, or ineffective or indifferent in providing all aspects of basic needs.

Lastly, there is no guarantee that transfer payments will be made available to the poor on a permanent basis.

While the role of direct transfer payments can not be denied for the bottom 10 to 15 percent absolute poor or unemployables, the fact is that market can not always supply wage goods, particularly public services such as education, health care, safe water, sanitation etc. It is essential to expand and redistribute public services so that the poor have access to such services. A part of the income of the rich needs to be transferred to ensure this expanded and equitable redistribution of public services. “There is no rule for the optimum which says that any rich man is permitted to spend his productive income all for himself, or the other way round, a poor individual has only the right to spend as little as his or her low productive income permits”.



In view of the above discussions the option (c) provides a pragmatic alternative to achieve the goals of an Islamic economy. In this connection it must be noted here that Islamic markets should be free of unsocial monopolies, hoarding, and unlawful speculation and other anti-social business activities that do not fit into the Islamic code of business ethics.

It is not out of place to throw some light on the behaviour of a firm and its objectives in an Islamic economy.

### ***The Behaviour of the Firm and its Objectives.***

The behaviour of the firm is to be guided by the overriding concern for public interest as viewed by the principles of the *Shari'ah*. It is relative to social need. It is neither the profit-maximizing nor sales-maximizing behaviour of the firm that matters most. What matters is the structure of the decision-making – institutional process that effects the substance of the decisions, so that different decisions will result from different kinds of organisation, even if all else is unchanged. In such situations we may reasonably expect the firm's goal to be not maximizing profits or sales but attaining a target level, or a rate of profit or a certain level of sales or a zero profit level (revenues equal to opportunity cost) or achieving an assigned social profit target. This means that the firm could come to rest in a large number of situations rather than in only one unique equilibrium situation. The main hypothesis is that in an Islamic economic analysis, equilibrium may not be unique. As such different theories may yield different predictions.

### **3(h) Industrial Relations.**

The conflict between labour and capital is the go of the capitalistic world. The growth of workers' and employers' organisation during the last few decades has been accompanied by a distinct increase in the number and extent of strikes and lockouts. A lockout which is the employer's answer to a strike is an act of closing a business enterprise by an employer for the purpose of enforcing a decision on the employees.

Islam does not recognise the exploitation of labour by capital, nor does it approve of the elimination of the business class and establishment of the classless society. Islam recognises the diversity of capacities and talents resulting in the diversity in earnings and material reward. It does not approve of a dead-level equality in the distribution of wealth as that would defeat the very purpose of diversity. Naturally, Islam recognises the existence of labour and capital in society. The two basic principles laid down in this connection, both in the Qur'an and the Hadith, are that the employee shall do his work faithfully and to the best of his ability and that the employer shall pay him fully for the service rendered. In fact, Islam brings about a happy marriage between labour and capital by giving the whole problem a moral bent.

It is clear that Islam has recognised the worker's right to a fair wage. When the employer tries to exploit the labour, they may opt for collective bargaining to secure Islamically justified fair wage. For, labour, being perishable has a very weak bargaining power. Thus a trade union can correct the bargaining weakness of labourers, eliminate capitalistic exploitation and so enable labourers to raise their wages to the level of the full value of their marginal net product. In fact the state can intervene to protect the legitimate interests of both employee and employers while an Islamic state can declare an anti-social strike as unlawful, it can very well fix the minimum wage to protect the interest of the working class. It follows that in a properly run Islamic society, there is no need to have collective bargaining power to the labour, because institutional arrangements will generate forces, where an equitable and fair conditions of work tend to be established.

But how far should the right to strike and discharge be allowed to go? What degree of limitation would the state law exercise? It is an unanswerable question, as no satisfactory answer can be given in an absolute term. The whole problem depends on a number of variables such as existing level of concentration of industrial power, level and stage of labour movement, level of social inequality and income, level of Islamic awareness towards work ethics and so on.

It may however be repeated that if both workers and employers are imbued with the values of Islam, the whole question of strikes and lockouts would be relatively unimportant. But the fundamental problem is not how to prohibit or restrict strikes and lockouts but how to inject Islamic values into the existing framework of industrial development in Muslim countries.

The crucial policy implication is that Islamic business ethics should form an integral part of either general or specific training designed for workers. There is also a need for an Islamic orientation training programme for management.

#### **4. ISLAMIC KEY THRUST IN SELECTED MACRO-ISSUES**

##### **4(a) Money, Banking and Investment.**

At this stage it is perhaps desirable to throw some lights on the concept of money, banking and investment in Islam.

##### ***Concept of Money and its Role***

In Islam money is viewed as a medium of exchange, not a commodity. The widespread acceptance of this role of money is intended to eliminate possibilities of injustice, unfairness and exploitation under the barter economy. Since injustices under the barter economy can, among others, be classified as *Riba-al-Fazal* which is prohibited in Islam, the role of money as medium of exchange is justified. Therefore, in Islam money does not in itself produce

anything. As such interest (*Riba*) on money lending and borrowing is prohibited.

Once the role of money as a medium of exchange is recognised, money can play its role as a unit of account and as a store of value in an Islamic economy. It can very well serve as a measure of opportunity cost (i.e., foregone income).

At a theoretical level, abolition of interest and imposition of 2.5 percent annum *Zakāh* levy on idle money are most likely to discourage speculative motive for holding cash, thereby contributing stability in the value of money. This is not to suggest that stability of money depends only on abolition of interest and imposition of *Zakāh*. It depends on other endogenous factors such as level of business activity, level of expected profit, commercial banks' ability to respond to economic incentives as well as exogenous factors such as the control of the Central bank. Nevertheless, absence of interest and presence of *Zakāh* levy puts an Islamic economy in a better position to handle the problem of unfair speculation and hoarding of money, thereby enabling money to perform its other derivative functions in an easier way. This does not mean that Islamic economy does not need a sound monetary policy. Because there is still a controversy as to whether central banks should have the sole authority of money creation in an Islamic economy or whether the commercial banks should also be allowed to create money by credit.

### ***Money as a Medium of Non-Exchange.***

In an Islamic economy money has a special social and religious role to play. Because, it provides the best measure for channelling purchasing power in the form of transfer payments to the poor. The transfer payments has its special religious significance in an Islamic economic society. Because in Islam it is not merely a voluntary obligation on the part of the Muslims but also compulsory obligations particularly in respect of payment of *Zakāh* by the rich to the poor. The religious significance of the role of money lies in the fact that it enables us to calculate *Nisāb* and to assess *exactly* the rates of *Zakāh*. Under the money economy, it is relatively easy to assess one's exact contribution in respect of one's intra-family and community obligations particularly where there is no end-product available for bartering. The point is that a scale of Islamically justified way of channelling transfer payments can be laid down more effectively under the money economy.

### ***Islamic Banking and Investment.***

As noted earlier, in Islam money does not in itself produce interest or profit and is not viewed as a commodity. Since *ribā* (i.e., interest) is prohibited, the status of the Islamic bank in relation to its clients is that of partners, investors and traders whereas in commercial banks in the West, the relation is that of creditor or debtor.

In its actual operation Islamic banks use various techniques and methods of investments such as *Mudārabah* contract under which financiers provide capital and the *Mudāreb* (labour partner) provides his technical know-how and skill and the profit is shared between the partners according to agreed percentage. Islamic banks are also involved in *Murābaha* (cost plus) contract under which banks purchase a certain commodity according to its clients' specifications and gives delivery on the basis sharing agreed ratio of profit. Under *Mushāraka*, both the banks and the clients enter into partnership by contributing capital in varying degrees and agree upon a ratio of profit in advance for a limited period of time gradually. The bank draws its contributions once the enterprise can stand on its own footing. Islamic banks are also involved in dealing with foreign exchange markets and other banking service operations such as letters of credit, and letters of guarantee. Islamic banks may also provide various non-banking services such as trust business, real estate and consultancy services.

It is to be noted here that Islamic financial market can provide a built-in-stabilizer to investment based on different types of financial instruments derived from *Mushāraka*, *Mudārabah* and *Murābaha* concept. Besides, the cost of investment being the function of rate of return is likely to be less prone to speculative gains rather than capital gains.

#### **4(b) Fiscal Functions and Policy: An Overview.**

The way the fiscal policy is expected to perform the *allocation*, *distribution* and *stabilization* function in an Islamic state has its own distinctiveness arising out of value orientation, ethical and social dimensions in public income and expenditure. The fiscal policy in Islam ceases to be neutral; and is expected to explain the situation not merely *as they are but as they ought to be*. Thus in an Islamic state the process of allocating resource use between private and social goods, adjustment of the distribution of earning and redistribution of existing income and wealth and the use of budgetary policy as an instrument of price stability, high employment and growth must provide a clear manifestation of social and moral concern in addition to material upliftment. This value loaded Islamic bias based on the principles of benevolence and care for the have-nots should enable the Islamic state to solve the problem of co-ordination or conflict of fiscal functions in a relatively easy way, as in the real world setting, budget planning does not frequently permit evaluation of various objectives on their own merits resulting in multiple conflicts between allocation and distribution, growth and distribution, stabilization and allocation and so on.

This overriding Islamic humane bias in public finance, for that matter in other areas of economics, is derived from *Zakāh* which contains an enormous potential for communal betterment in favour of the poor and disadvantaged members of the community. The Qur'ān points out the items on which *Zakāh* revenues can be spent. The *Zakāh* which is to be collected only from the Mus-

lims can be used for the welfare of the non-Muslims as well. But by payment of *Zakāh* Muslims are performing their religious duties also. Thus *Zakāh* levy has a double sanction – spiritual and temporal, not the double nature – religious and secular as wrongly maintained by some western scholars. This is true with regard to most of taxes of early Islamic state.

In spite of the simplicity of the system, there were a number of taxes prevalent in the early Islamic state. Generally speaking, they are: (a) *Zakāh*, (b) *Jizya*, (c) *Kharaj* or land tax, (d) Spoils of war, (e) Taxes on mines and treasure trove, (f) Custom duties and tolls.

It is possible to demonstrate that tax system of early Islamic state was elastic and dynamic in nature. For example, the categories of property to which *Zakāh* is to be applied is not rigidly maintained even by Hadrat Umar himself who introduced a number of changes in the system of *Zakāh*, because it is a means to an end, not an end in itself.

### ***Basis of Budgeting.***

Again a careful study of the *Shari‘ah* provides us some interesting clues as to what should be the basis of budgeting in Islam (i.e., revenue-vs-expenditure).

In an Islamic state, the basis of budgeting is not merely the revenue which should determine the expenditure. It is the expenditure which should primarily serve as a basis for mobilisation of revenue. It stems from the Islamic requirement that a state should provide a basic minimum need to all its citizens. Therefore, if the *Zakāh* revenue and contribution of the voluntary sector, recognised by Islam, are not sufficient to meet the basic provisioning for the poor, there is always a scope for additional taxation beyond *Zakāh* provided they are spent in judicious manner. It is therefore implicit that a case of deficit financing can be made in an Islamic economy. This can be arranged through *Mudāraba*, *Mushāraka* and *Murābaha* contract. Besides, Islamic government can also raise funds by issuing investment bonds and certificates to the public on the basis of profit-and-loss sharing.

From the preceding discussion, it is clear that an Islamic state should be able to use various fiscal instruments or policies designed to have an Islamic “Social Welfare Function” which describes society’s judgement on the question of weights to be given to the welfare of various individuals and groups (i.e., poor, aged, low-income group, minority).

Let us now have an overview of the monetary policy in an Islamic state on the assumption that fiscal and monetary measures can supplement each other, although they differ in their impact.

### **4(c) Monetary Policy: An Overview.**

It is widely felt that in an Islamic economy monetary policy should pursue

the goal of maintaining “stability in the value of money, economic well-being full employment and optimum economic growth and promotion of distributive justice”. It is thus widely believed that the central banking system in an Islamic state must control the supply of money and money supply be adjusted to the need of the economy in terms of both short term stability, long term growth and allocation of bank resources to help realise the goal of social welfare.

Thus despite the abolition of interest rate and non-availability of open market policy a number of monetary policy instruments such as cash reserve ratio, liquidity ratio, credit ceilings, “profit-sharing ratio” in different sector financing and moral suasion can be legitimately used in an Islamic economy as components of stabilisation, distribution and growth policy. Besides, due to its effects on international capital movements, monetary policy will have a special advantage in securing balance of payment equilibrium.

As regards power to create credit by commercial banks, there exist some controversies. But the predominant view is that commercial banks should have the power to create credit provided its benefit does not go only to big business firms controlled by a family or a group of inter-locking directorates of firms or banks to the neglect of the larger interest of the society. This has crucial policy implications particularly in the case of poor Muslim countries where conscious policy measures are to be taken by the central bank to bring about a more equitable distribution and allocation of the bank resources (in the form of rural credit) to help financing the agriculture sector, rural development, and agro based industries so that benefits go to rural areas, where bulk of the people live in most of the Muslim countries today.

As noted earlier, that Islamic economy, being essentially equity based rather than loan based, the ideal alternatives to interest are profit and loss sharing and *Qard-Hasan* in production and consumption areas respectively.

### ***Policy Mix***

An Islamic economy does provide a scope for securing a policy mix of monetary and fiscal policies which will permit to achieve more objectives than would be possible with the use of one policy instrument alone.

### **4(d) Economic Development**

The goals of Islamic concept of economic development can not be explained in terms of Gross National Product, and increase in per-capita income only. It must also be explained in terms of raising the absolute income levels of the poor to eradicate poverty, meeting material, non-material human needs, conservation of natural resources, wildlife and ecological environment. In addition, the goals of Islamic concept of development must be designed for the preservation of moral and spiritual values as reflected in the concept of *tazkiyah* (moral purification plus growth).

Despite the fact that the Islamic basis of development is multidimensional having its moral, social, political and economic dimensions, moral and spiritual development need to be integrated into the very concept of economic development right from the beginning. This is what is called *Tazkiyah al-nafs*.

Thus, economic development of Islam is *not* simply materialistic development. The spiritual and moral phases are assigned capital importance, and they were made explicit in *takāful* or *tadāmun*, or mutual social security of Islam. Ideal pattern of Islamic belief contains enough motivational properties to *work* which can influence actual patterns of Muslim behaviour. It is possible to motivate economic achievement, thereby accelerating economic development through a systematic programme of moral educational training. In Islam “work” for the purpose of efficient utilisation of His resources is also a worship. Besides payment of *Zakāh*, benevolent loan, voluntary and obligatory intra-family and intra community obligation carry the double notion of benefits; they do not merely bring material benefits to takers, but also give benefits to givers both morally and socially.

Let us now put forward some alternative strategies for development in an Islamic framework as hypothesis having clear Islamic dimensions.

- 1) Emphasizing people at a gross-root level and their Islamic values in a particular development context, thereby developing an appropriate model of development from within.
- 2) Emphasizing “basic need” rather than “effective demand” in development planning.
- 3) Emphasizing integrated rural development.
- 4) Emphasizing social appropriateness in technology.
- 5) Emphasizing education and schooling aiming at total human development.
- 6) Emphasizing mobilising resources through defining the scope for social help, individual freedom and group behaviour.
- 7) Emphasizing complementarities and substitutabilities in development for fostering co-operation among the Muslim countries.
- 8) Emphasizing conservation of humanity through fulfilling inter-generational obligation.
- 9) Emphasizing preservation of biological diversity and conservation of resources.

The alternative strategies discussed so far are by no means exhaustive. Economic development in Islamic framework has to be understood in its total *relationship* with social political, ethical variables. The difficulties often lie in lack of (a) appropriate human attitudes, (b) inappropriate administrative and social institutions, (c) failure of bureaucracy to identify them with people, and (d) nepotism and corruption. Despite the fact that there are no fixed capital co-efficients between resources spent and a desired change in human at-

titudes and individual motivation to work, scarce resources need to be allocated to carry out necessary social and institutional reform. In any given political structure, attempts to piecemeal reform may be self-defeating. The system is likely to re-establish the initial distribution of power and wealth. It follows that each of the strategies as outlined must not be seen in isolation from one another. It is only through *total relationship* that full manifestation of Islamic concept of development should be possible. It is only then a deep structural reform will take its root.

#### 4(e) Poverty

Contrary to popular notion, human poverty in Islam is indeed concerned with both material as well as cultural and spiritual poverty. This dual notion of poverty has its roots in the *Shair'ah*. While it should be possible to identify a number of economic, social and moral value-oriented variables and indicators to assess the extent of poverty resulting from the de-Islamization process the current analysis is mainly confined to the discussion of material poverty and Islamic responses to it.

While it is difficult to quantify the level of extent of material poverty, it is possible to integrate "minimum subsistence", "minimum adequacy" and "minimum comfort" into definitions of poverty. The *Shari'ah* requires that Islamic state must provide a guarantee of a minimum level of living to all. But it is conditional and relative. For, individual must first, try to earn his living through his efforts. Again, this guarantee is relative to socio-economic conditions of the society concerned. But when people are living at a subsistence or starvation level, it is important that we must attack absolute poverty rather than relative poverty as a matter of priority. Although the concept of human poverty involves considerable value-judgement particularly in construction of an index of relative deprivation or equivalence in consumption and income, it should be possible to identify the causes and to suggest remedies consistent with the spirit of the *Shari'ah*. In most cases poverty in Muslim countries arises due to colonial exploitation and legacy, implementation of inappropriate development policies resulting in economic and financial dualism, neglect of human resources, low labour productivity and so on.

Lastly, Islamic solutions to the problems of poverty may include among other things, three basic lines of actions:-

- (i) Initiating institutional and non-institutional reforms through legal and non-legal measures such as (a) re-structuring the development policies geared to the need of the rural population, (b) introducing necessary reform in land tenure (c) progressive taxation to transfer funds for providing public goods such as education and training, health care and so on.
- (ii) Providing Guaranteed Minimum Provision (GMP) to all concerned, determined by the level and stage of social and economic



development to meet the basic minimum needs rather than provision for a national minimum wage (NMW). Although a case can be made for NMW in an Islamic economy, it is only a partial solution to the problem of poverty as NMW concentrates its benefits upon those who remain in employment.

- (iii) Re-constructing and re-activating the conventional tools of re-distribution such as (a) collection and disbursement of *Zakāh* to achieve pre-planned objectives, (b) redefining the scope and limits of intra-family obligatory allowances and obligatory social provision of certain goods and services in a particular social context, (c) fuller implementation of Islamic laws of inheritance and so on.

Each of the above-mentioned lines of approach is rooted in the *Shari'ah* in one way or other. However, the question of minimum provisioning for living deserves a special treatment in view of its importance in the *Shari'ah*. Therefore, a brief explanatory note is needed.

***Minimum Provisioning for Living: An explanatory note***

While the *Shari'ah* stressed upon the individual to earn a livelihood, yet it is also recognised by the Qur'an and the *Sunnah* that a state of poverty and deprivation entitles one to community's support, as guarantee of a minimum level of living is to be provided by an Islamic state. It is suggested by some scholars that an Islamic state must provide a constitutional guarantee for providing minimum provisioning for living so that court must have jurisdiction to take appropriate legal measures against the public treasury to enforce that minimum, if necessary. This is perhaps an ideal Islamic position.

But in the context of today's reality, it is very difficult to give a categorical answer as to whether all Muslim countries (excepting a few oil rich countries in the Middle-East) are capable of giving a guarantee of a minimum provisioning for food, shelter, clothing, education and health care to their people. In the case of many least developed Muslim countries the minimum provisioning for the shelter alone can perhaps, eat up the budgetary resources leaving practically nothing for other items of the vital expenditure. The basic question which I am raising here is the following. When a state can not provide a guarantee of a minimum provisioning to its poor people as required by the *Shari'ah*, due to its resource constraints, it is perhaps in order to identify the order of priority in terms of minimum provisioning, thereby providing a guarantee for at least priority needs, although it may be a guarantee for sub-minimum provisioning. This is not to suggest that this second best solution should be a permanent feature in any Muslim society. Attempts should however, be made to exploit the resources in such a way so that it becomes possible to break the vicious circle of poverty. This is perhaps Islamically justified approach to the problem.

#### **4(f) Co-operative Insurance**

There is a feeling that insurance is un-Islamic, because it is said that it is nothing but gambling or speculation. But there is a fundamental difference between gambling and insurance. While gambling promotes dissension and hatred and tends to deter those who indulge in it from remembrance of Allāh, insurance is based on co-operation and the insured individual is enabled through mutual action to obviate poverty for himself and his dependents. There is nothing in Islam which prevents anyone from making provision for his dependents. In fact, through insurance, the society as a whole gets benefits out of accumulation of capital reserves.

The difference between modern insurance industry and Islamic insurance industry lies not only in its form but also in the nature of its handling the business. The present-day trend toward formation of cartel like associations of entrepreneurs in the field of insurance is the negation of Islamic values of life. We know that the modern insurance industry invest their funds in interest-bearing undertakings. But the Islamic insurance companies will provide capital loans instead either directly on the basis of *Mudārabah* or in participation with Islamic banks and other specialised credit institutions.

Under Islamic scheme contributors to the insurance fund are donors, and their contributions are donations, with the aim being to share out the losses that befall on any of the contributors among them all. The compensation given is relevant to the loss incurred and not a fixed sum which is agreed between the insurer and the insured at the time when the contract is made.

Insurance schemes made by the government are also permissible since they are a kind of fulfilling the state's duty to look after its citizens and alleviate the hardships that they encounter.

It is interesting to note that Islamic co-operative insurance has already been put into practice by the Faisal Islamic Bank of Sudan and Dar Al-Maal Al-Islami. Their initial success are indeed encouraging and provides a scope for further expansion.

#### **5. SUMMARY AND CONCLUSIONS :**

Taken all in all, the following major conclusions emerge from the preceding discussion on various key issues in Islamic economics.

- (a) Islamic economic value is an integrated part of a social framework which knows no distinction between a spiritual and a material activity of man. Society or state in Islam is for the individual who is accountable to Allāh for his actions. It is the state which enforces the Islamic laws and can make individuals fulfil their obligations towards society. But the rulers cease to deserve obedience, should they transgress the limits of *Shari'ah*. These checks and balances are found in all dimensions of Islamic social framework.

- (b) It is a Muslim world-view that the concept of private ownership of property is relative, as absolute ownership of everything belongs to Allāh alone. So, the state can prevent individual from misusing his ownership to the detriment of the society. There are definitive rules of the *Shari'ah* governing private ownership of property.
- (c) Islam provides a comprehensive ethical framework under which all factors of production must operate. While production is emphasized, distribution remains an integrated part of production strategy right from the beginning. Thus, all members of the community are entitled to pure economic rent. One must get 'due' compensation for one's effort (i.e., fair wage and normal profit). Islam also discourages misuse of resources to the disadvantage of the future generation. Interest is prohibited, because it helps growth of capitalism; creates unemployment problem; retards the process of recovery during recession and depression; introduces instability; aggravates debt servicing problem and distributive justice and uproots the principles of co-operation. The so-called allocative function claimed to be performed by interest rate can be done by expected rate of return in an Islamic economy. Capital is *not* costless in Islam.
- (d) Consumption is a positive concept in Islam. The key to its understanding lies in the concept of "moderation in consumption" defined as such in a particular social and economic context.
- (e) Islamic economics is co-operative, competitive and controlled all at the same time. The unique mix of such principles can provide insights into the working of an Islamic market and a firm which may be guided by multiplicity of objectives and equilibrium of the firm may not be unique.
- (f) Islam recognises the diversity of talents and capacities resulting in the diversity of earning and material rewards. It is required that employee shall perform his work faithfully and the employer shall pay him fair wage.
- (g) Islam views money as a medium of exchange *not* as a commodity and the status of the Islamic bank in relation to its clients is that of a partners, investors and traders. In its actual operation Islamic banks use various techniques of investments based on profit-and-loss sharing basis on the grounds of stability, allocative efficiency, growth and distributive justice. Islamic economy is essentially equity based. Cost of investment being the function of the rate of return is likely to be less prone to speculation.
- (h) The value-loaded Islamic bias based on the principles of benevolence and care for the have-nots should be manifested through fiscal and monetary policy in an Islamic state. While essential expenditure may primarily serve as a basis for budgeting, a number of monetary

policy instruments such as cash reserve ratio, liquidity ratio, credit ceilings can be used to perform stabilization, distribution and allocation functions.

- (i) Lastly, Islamic concept of development is multi-dimensional with a focus on development of man in its total relationship with economic, social, moral, spiritual variables and physical natural environment – both natural and institutional. Thus efforts must be made to remove human poverty, as the Islamic state is to provide a minimum level of living to all its members. Evidently, co-operative insurance for making provision for one's dependents is permissible.

## 6. SELECTED FURTHER READINGS

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- M.N. Siddiqi : Rationale of Islamic Banking. 22 p.
- M.M. Metwally : A Behavioural Model of an Islamic firm. 13 p.
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1. K. Ahmed (ed.) : Studies in Islamic Economics, 1980, 390 p.
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4. M.A. Chowdhury : Interest Rate and Intertemporal Efficiency in an Islamic Economy: Issue Revisited, 1982, 46 p.
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