

ISLAMIZATION AND THE PAKISTAN ECONOMY

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Cover Photo: View of Pakistan's Landmark Faisal Mosque in Islamabad, © Reuters/CORBIS

CHAPTER 2

Islamizing the Economy: The Pakistan Experience

KHURSHID AHMAD

Khurshid Ahmad, founder and chairman of the Institute of Policy Studies, Islamabad, was selected in February 2003 to serve in the Senate of Pakistan. During an earlier tenure in the Senate from '1985-'1997, he was chairman of the Standing Committee on Finance, Economic Affairs and Planning. He has also held the positions of federal minister of planning and development and deputy chairman of the planning commission. He has authored, edited or translated over 70 books, including Crisis of Political System in Pakistan and the Jama'at-e-Islami, Studies in Islamic Economics (editor and contributor), Towards Monetary and Fiscal System of Islam, and Economic Development in an Islamic Framework.

I am extremely grateful to the Woodrow Wilson Center for providing all of us with an opportunity to share with each other reflections on certain key concepts of Islamic economy and salient aspects of the Pakistani experience, in the context of their implications for the world economy.

Islamic economics, although rooted in the values, principles and commands contained in the Quran and Sunnah, is neither a branch of theology (*Kalam*) nor of law (*Fiqh*). It represents an *approach* to the fundamental questions of economics — i.e., what is to be produced, how is it to be shared, and what is to be the shape of final consumption in a society?

Man's economic problem is as old as are humans on the earth. While economics as a social science has been developed only during the last two centuries, the economic problem has always been there. Humans, in all times and climes, have strived to grapple with the economic problems at conceptual as well as practical levels in different civilizational contexts.

Islamic economics is a nascent yet evolving discipline. It represents a fresh approach to economics and the economic problems of mankind.

Economic discipline and economic policy as they have developed in the West during the last two hundred years pose certain problems. All economic relationships have two dimensions: one technical, which relates to the physical or positive laws of production and consumption, and the other normative and ideological. The two are intertwined. Wherever there is a question of choice, there has to be a moral dimension. Choice can be motivated by physical and positive considerations, but choice is also influenced by our moral values and normative considerations. Over the years, economic science, even policy formulation to a certain extent, has witnessed what I call a de-linking between the positive and the normative dimensions. The founding fathers had developed their conceptual frame-work on certain moral and ethical assumptions, sometimes explicit, often implicit. Over the years the separation between ethics and economics has been accentuated with far-reaching consequences for the theory and practice of economics.

A, second development relates to separation between economics and other social disciplines. Gradually economics tried to become a self-contained social discipline, parting ways with its integral linkage with politics, sociology, psychology and other disciplines. Obsessed by the idea of making economics a more and more positive science, an eagerness to introduce quantitative

methodologies of physical sciences, particularly mathematics, is partially responsible for this de-linking from other social sciences.

Thirdly, the pursuit of efficiency and optimal allocation of resources became the central problem of economics. Efficiency is a very important concern, but over the years, considerations of efficiency have become so dominant that the equally important dimensions of equity and justice and of social and ecological consequences of economic efforts became eclipsed. Issues of distributive justice, quality of life and sustained growth were marginalized. Consequently the link between wealth and well-being was drastically weakened if not totally severed.

Finally money, which was primarily a medium of exchange, a measure of value and a powerful instrument for financial intermediation, became an objective in itself. The institution of interest played a crucial role in this transformation. Consequently, the critical link between money and the physical economy was thinned out. Money became a commodity. An expanding fiduciary space emerged, which has ballooned ever since, occupying a central realm in the world economy. To give just one example: foreign exchange is primarily an instrument for facilitation of international trade and exchange of services. Yet presently, daily turnover in foreign exchange in global markets is more than 50 times that of total volume of international trade. The make-believe world of derivatives has overtaken the physical economy.

These four major de-links have transformed economics. Efficiency and equity in the world economy no longer go hand in hand. While global production has increased exponentially, economic miseries of almost two-thirds of humanity remain unrelieved. Almost 87 percent of the world GDP is concentrated in the hands of less than 20 percent of the world population in developed countries, even if gross inequalities within the developed world are ignored. The world is becoming more and more inequitable. The ratio of wealth between the rich one-fifth and the poor four-fifths of the world was 30:1 in 1950, which increased to 60:1 by 1980 and at the advent of the 21st century it had roared to 85:1. Yet people all over the world, and countries rich and poor, are groaning under ever-increasing mountains of debt. The United States, the richest country of the world, is also the most indebted country on the globe. And there is the plight of the poor. At the advent of the 21st century all are faced with an explosive situation.

The predicament in which we find ourselves is, among others, a result of these four major de-links. Islamic economics represents an effort to search for a new paradigm. We are not seeking some changes within the economic paradigm of capitalism, which is the dominant system. The effort is aimed at paradigm change. The idea is to address basic economic problems from a moral and socially responsible perspective. We seek to reintegrate economics with ethics. Efficiency and equity become elements of a composite reality. Instead of a piecemeal, incremental approach, our approach is more holistic, integrated and all-embracing. We want to refocus on growth involving production of useful goods and services and on asset creation, as against financial ballooning. Productive efficiency and distributive justice are twin objectives, inalienable elements of an integrated whole. This, broadly, is the roadmap to a new paradigm.

While abolition of interest and introduction of zakai are two pillars of the Islamic economic system, Islamic economics represents much more than that. It represents a new approach to economics, including resort to some new methodologies to come to grips with the eternal issues of the economy: what is to be produced? How is it to be distributed? And how would it be consumed?

Let us not forget that the right of private property, freedom of enterprise, the market mechanism and the profit motive predate capitalism.

While capitalism built its system on the foundations of self-interest — private enterprise, markets and profit—its unique contribution lies in giving them a particular shape and role. They are not unique to capitalism. Private property and enterprise, self-interest, the market mechanism and competition are integral to the Islamic economic system. Yet their distinct character and role are fashioned by the value framework of Islam. The individual is the building block of the society and private enterprise is a premium mobile of the system. Yet property rights, legal and sacrosanct, have a dimension of social responsibility. A fundamental Islamic concept is that property, power, and authority — at all levels including state authority — are in the nature of trust. Within the framework of this relationship of trust there are clearly defined lines and limits of rights and obligations.

As such, moral and social dimensions are integral to the reality of individual rights. In fact, rights and duties represent two sides of the same coin. Competition and cooperation go hand in hand. Market mechanisms operate in the context of different sets of moral filters and societal and legal regulatory mechanisms. The state is neither the police state of the liberal democratic model, nor a totalitarian entity of the socialistic brand. Primarily, its function is to maintain law and order, ensure national security and provide a congenial regulatory environment for civil society and the economy to operate and prosper. But establishment of justice is also an overriding function. This is so not merely in the sense of legal justice, but also concern for and commitment to political, social and economic justice. The state has a more positive role to play, without suppressing individual liberties, participatory processes and the democratic character of the society, economy and polity. Self-interest is hedged by moral concerns. Freedom goes with social responsibility, competition is complemented with cooperation, and efficiency with justice. This is our vision of an economy and this concept has relevance not only to Pakistan and the Muslim world, but to human society anywhere in the world. The issues of property rights, intellectual propriety, competition, self-interest, efficiency profit, growth and accountability are our common concern. So are questions of justice and well-being. There are certain similarities between the Islamic and the capitalistic order. There are equally important dissimilarities and divergences. It is the unique ethos of Islam as that of liberal capitalism that defines the role and character of these fundamental concepts, in the two geo-economic profiles.

Islamic economics is not isolationist and autarkic. It has a universal relevance. There is trade-off with other systems. There could be diversity within the Muslim countries and between the Muslim world and the rest of the world, despite areas of agreement and disagreement and convergence and divergence. International trade, movement of capital and investment, and ever-increasing economic and financial relationships between individuals, groups and states at the regional and global levels are integral to the Islamic system. Of course there are certain areas where readjustments and realignments would be needed, particularly because of the Islamic sensitivity with respect to interest and ethical investment. But it should be clear that the Islamic agenda for eliminating interest does not involve any denial of profitability of capital or its right to enjoy a just return. What is disputed is a predetermined fixed return on capital, without sharing the risks of enterprise. Capital is entitled to a return based on its actual productivity. While facilities for credit are not denied, an Islamic economy is primarily an equity-based economy and not a debt-based one. It is a sharing and stake-taking economy. Equitable sharing is as important to the Islamic milieu as efficient production.

As to the Pakistan situation, the concept of Islamic economics is an essential part of the very concept of Pakistan. The Objectives Resolution passed by the Constituent Assembly of Pakistan in 1949 and the Constitution of Pakistan contain essential elements of the vision of Islamic economics. However, very little effort was made to actualize this vision, particularly in the public

sector. It was during General Zia ul-Haq's period that some piecemeal and disjointed efforts were made in that direction. That process too did not go far enough. Most of the changes were only ornamental. That is why they could not bring any substantial change in the system. In the private sector, however, a number of pioneering efforts have been made to bring economic relationships into harmony with Islamic values. Many enterprises and institutions have tried to switch over to equity finance. There are quite a few cases of success stories in the private sector. In the fields of education, social services and poverty alleviation too, the private sector has made distinct contributions. To give an example the allocation in the federal budget for social services is almost negligible — less than 0.8 percent of the GDP for health care and only 1.8 percent for education. However it is through private philanthropy that over 70 billion rupees per year are provided for these support networks. This is equal to almost one-tenth of the total federal budget, of which 50 percent goes away in payment of interest on external and domestic debts and almost 30 percent is spent on defense. People are surviving because of private philanthropy. There is no nationwide state-based system of social security.

The Supreme Court judgment of 1999 and, before that, the judgement of the Federal Shariah Court of 1991 on elimination of *riba* are important documents, but they have failed to make any real dent in the system. Their implementation is still far off. However, the State Bank of Pakistan has taken some serious initiatives in the recent past and there is an increasing response from the financial and business sectors. This becomes all the more important in the context of the Islamic revivalist movement in the country. A number of Islamic banks or Islamic banking branches of conventional banks have been established during the last three years. It is too early to evaluate their performance. The possibilities of success are bright. It may be recalled that the global Islamic banking movement gained strength when the first Islamic bank in the private sector was established in Dubai in 1975. The Islamic Development Bank, Jeddah, was also established in the same year at the initiative of the governments of the Muslim countries. Presently there are over 300 Islamic banking institutions operating in some 40 countries of the world. The asset base of these banks is around 250 billion dollars and their deposits and advances exceed 300 billion dollars. The overall performance of these Islamic banks is generally regarded as positive and encouraging. Most of these banks operate in the private sector, some with limited government or institutional participation. Iran and Sudan have made some efforts to change the entire financial and banking system through state-sponsored change, but with limited success. However, in the private sector the rate of growth of Islamic banks is three to five times higher than the rate of expansion of conventional banking. Being newcomers, the rate was expected to be faster because of the low base, but the fact that they have competed successfully with established conventional banking and have carved out a significant space for themselves, both by partly taking over from conventional banking and partly creating a new market, goes to their credit. A number of new financial products have evolved. *Shariah* compatible trading and financial organizations are on the increase. There is an emerging Islamic capital market. Redesigning of accounting and auditing practices is taking place. Ever-expanding efforts towards dialogue, discussion, research and experimentation represent a very positive development and hold promise for the future.

It is mainly in the private sector that Islamic banking has made some substantial progress in Pakistan, Kuwait, Malaysia, UAE, Bangladesh and others. Every Muslim country has its own model, despite many similarities and commonalities. The Islamic Development Bank is playing an important role in promoting Islamic banking in the world. As to Saudi Arabia in my view, Islamic banking remains a less developed sector. While interest-based contracts cannot be enforced through the courts of law, the banking system, by and large, is operating on the basis of interest. One major bank and interest-free windows in some other banks have appeared during the last decade. At the theoretical level a lot of work is being done on this subject. There is a heightened interest by the

public and professionals through exchange of ideas and experiences via conferences, seminars and visits. There is no central Islamic bank so far, although the Islamic Development Bank has played an important role in promoting interaction between Islamic banks worldwide.

As I have said earlier, elimination of interest and promotion of zakat is only one aspect of the Islamic economy. Similarly zakat in most of the Muslim countries is instrumental in providing some kind of a social security net to the underprivileged classes-The effort to reform or restructure the economies of the Muslim world is still in an early phase. The objectives of an Islamic economy are now more widely acknowledged. These objectives primarily are strengthening the moral fiber of the individual and the society (*taqwa*), and ensuring provision of *adl* (justice) and *ehsan* (benevolence) for all human beings.

Finally, our vision of Islamic economics is one where on the one hand Muslim people should have an opportunity to order their economic life in accordance with moral and social ideals of Islam, but on the other they are equally eager to promote cooperation and co-existence with the rest of the world, wherein every people should be equally entitled to establish its economy according to its own values and vision. We firmly believe that competition is important not merely within a given economic system but also between economic systems. This is important for the progress and well-being of humanity. Hegemony of any one system throughout the entire world cannot but signal the "end of history;" as progress comes from diversity, healthy competition and cooperation among the nations.

Robert Fogel, winner of the 1993 Nobel Prize for economics, says in his recent book *The Fourth Great Awakening and the Future of Egalitarianism*:

At the dawn of the new millennium the critical issues are no longer whether we can manage business cycles or whether the economy is likely to grow at a satisfactory rate. It is not even whether we can grow without sacrificing the egalitarian advances of the past century. Although the consolidation of past gains cannot be ignored, the future of egalitarianism in America rests on the nation's ability to combine continued economic growth with an entirely new set of egalitarian reforms that adhere- to the urgent spiritual needs of our age, secular as well sacred. Spiritual (or immaterial) inequity is now as great a problem as material inequity, perhaps even greater.

John Gray, a British economist, in his book *False Dawn: the Dimension of Global Capitalism* makes an important observation on which I would like to conclude my presentation:

A reform of the world economy is needed that accepts a diversity of cultural regimes and market economies as a permanent reality. A global free market belongs to a world in which Western hegemony seemed assured. Like all other variants of Enlightenment. Utopia of a universal civilization it presupposes Western supremacy. It does not agree with a pluralist world... It does not meet the needs of a time in which Western institutions and values are no longer universally authoritative, it does not allow the world's manifold cultures to achieve modernizations that are adapted to their historic, circumstances and distinctive needs.
