

## **Meeting the Global Challenges: Role of Islamic Economics**

### **Welcome remarks by Mr. Khalid Rahman, DG IPS**

Excellency, Mr. Tanaka, Ambassador of Japan, speaker Dr. Muhammad Umer Chapra, and IPS Chairman Prof. Khurshid Ahmad, distinguished guests; ladies and gentlemen! I welcome all of you to this second day of our lecture series on “Global Economic Challenge and Islam”. Yesterday we discussed the compatibility of Islam and Globalization and today we are going to discuss the role of Islamic Economics in meeting the global challenges in the context of globalization. And tomorrow and day after tomorrow we are going to have two more lectures on the same theme.

I am glad that yesterday the Ambassador of the European Union presided over the session and today we are having Mr. Tanaka, Ambassador of Japan, which is undoubtedly one of the biggest economic powers of today’s world. So, it is naturally a very important player in globalization. When we go to his CV, we find that he had a distinguished career right from 1970 when he joined the Japanese Foreign Office. In addition to serving in a number of countries, he has also been a part of research activities in the Japanese Foreign Office. While Islamic Economics may be somewhat strange to him, as he was just sharing his views with us before this session, the academic activities, the intellectual discourse and various aspects of globalization and the economic challenges that the world is facing today may perhaps not be strange to him. We will be greatly benefited by his remarks. Before I request the Chairmen to take over the proceedings, I request the IPS Chairman Prof. Khurshid Ahmad to kindly introduce the theme of today’s lecture — ‘Meeting the Global Challenge – the Role of Islamic Economics’.

**Prof. Khurshid Ahmad:**

*Bismillahir Rahmaner Rahim!*

Excellency Mr. Tanaka, Dr. Umer Chapra, my respected friend Mr. Agha Shahi, dear friends, colleagues, ladies and gentlemen! Once again it is my pleasure and honour to welcome all of you to this lecture program, second in the series. We are extremely glad to have Dr. Chapra as our keynote speaker for this series where he is trying to address in the context of globalization, the challenges and issues that confront humanity today in general and of course the Muslim world in particular.

Dr. Chapra is a distinguished economist. He has researched and talked about the subject in different universities around the world, including Pakistan, United States of America, and Saudi Arabia. He has been one of the chief architects of the Saudi Arabian Monetary Agency, which is the central bank of Saudi Arabia. Presently he is associated with Islamic Development Bank and is Senior Advisor to the Islamic Research and Training Institute, which is a research wing for Islamic Development Bank.

He is the author of a number of books, written dozens of articles, and participated in a large number of conferences and seminars globally. His three major books, one is; “Towards a Just Monetary System”, which has been a path-breaking study on the Islamic monetary system, addressing issues relating to *riba*, its elimination, and the alternative model which can provide a banking and financial system without *riba*. His other work; “Islam and the Economic Challenge” has been acknowledged in academic circles all over the world as a major contribution not only as an exposition of the Islamic system but also a critique of capitalism, socialism, welfare state, and development economics. It effectively argues how Islam and the Islamic approach can help in facing those challenges. This book is not only a contribution to Islamic economics but has something that would help even Western economists in a better understanding of the issues faced by our time. And then, his latest work on “The Future of Economics : An Islamic Perspective” is a critical review of the developments in the field of Islamic Economics

over the last forty five years, and how they are related to the overall economic challenge of our times.

We are happy that he is with us for this series of lectures. Today he is going to share his thoughts with us on “Global Economic Challenge: Role of Islamic Economics”. Economic teachings of Islam have been expounded over the last fourteen hundred years in different forms by different thinkers. However, Islamic Economics as a social discipline and a more focused study of the economic problems from an Islamic perspective, in the making of which professional Muslim economists in particular and Muslim ‘*Fuqaha*’ (jurists) in general have contributed, is only last thirty years or so. This discipline has been developed and is still developing. It is a nascent discipline, yet it has brought to bear a distinct approach to Islamic problems both at the conceptual and theoretical levels as well as at the level of policy formulation.

The global challenges that we face at the moment are many. It is difficult to catalogue them. However, I would highlight a few, which I think are the most challenging ones. The first and foremost of these is that while we have witnessed, particularly in last two centuries, tremendous growth, industrial revolution, managerial revolution, IT, and revolution you name them, and there has been Himalayan rise in economic wealth, GDP, yet we find that a majority of human beings on the globe are either faced with prospects of dire poverty, hunger and deprivation. They are denied the basic needs, the fulfillment of which is necessary for an honourable life.

It is also very intriguing that despite this progress, despite all this economic transformation, when we compare the beginning of the twenty first century to the state of the world in the last half of the 18th century, we find that studies have shown that globally the dispersion of wealth and the availability of basic necessities of life was more just, more wide spread. All these studies show that at the end of the 18<sup>th</sup> century, the present day Europe had around 27% of the world industrial products whereas the United States of America had only 1.4% but what is now deprived, the third world, had over 70%. And, to give a wake up call to the Muslim world today, it was 40% of the product. The situation today is that 21 countries of the world possess 87% of the world wealth and the

rest of the world, 180 countries having over 80% of the world population, is surviving at only 13% of the world wealth, and these disparities are increasing. Is this the measure of economic prosperity? This is because the link between wealth and well-being has been severed. The moral values and economic resources, the link between them has been broken. I think Dr. Chapra is going to address all the challenges that we face but in my view this is the biggest one.

The other problem is that we have built a world where money has become a commodity and an object in itself. As long as money was a medium of exchange, a measure of value, a facilitator of economic activity for production, the focus was on the physical expansion of the economy, and money was facilitating it. Now we have created a world where money has been trying to generate money without generating goods and services. Asset creation, production of goods and services is no longer as inalienably tied to money circulation. So we are trying to have more and more fiduciary world. Today the world GDP is between 40 to 45 trillion dollars but a few hundred banking and financial players and derivatives, their trade now exceeds over 700 billions a year. And that is how billionaires and billionaires are being produced while a majority of humanity is starving and unable to have the benefit of money. So, that is the issue.

Here I would not dilate more, Dr. Chapra would give details of these things but I would like to conclude by saying that I am so happy that today we have the Japanese Ambassador with us. Japan in my view provides a kind of ray of hope even though the contemporary Japanese economy is definitely cast in capitalistic moulds. However, when we look into the Japanese history, particularly the Meiji reformation, we find that the Japanese model for economic development had been one in which, while all the parameters of industrialization had benefited from the European models, it was not an import or an adoption. It was rather a reformulation, keeping in view the economic reality and the value framework. Although in the post Second World War phase that original dynamism, balance and equilibrium were disturbed, my study convinces me that even in the post-1980s crisis, from which Japan has now been emerging, the way Japan tried to face this crisis was not in the framework of classical capitalism. In spite of all the changes

that American thinkers and policy makers were selling to Japan, Japan trying to come out of the crisis by drawing upon its own traditions without destroying the human relationship that has been the source of strength of the Japanese corporation as against the totally impersonal structure of corporate life.

From that viewpoint, I think Islamic Economics represent an approach where the values, where the social system, where the cultural contacts and, more important, human values and human dimensions take the central place. In that context, I think that the Japanese model and the approach of Islamic Economics have significant symmetry, despite a number of dissimilarities in that context, I welcome His Excellency to this program and I would request the speaker, Dr. Chapra, to please address the audience.

**Dr. M. Umar Chapra:**

Your Excellency Mr. Tanaka, Your Excellency Mr. Agha Shahi, Prof. Khurshid Ahmad, brother Khalid Rahman, ladies and gentlemen! The subject of my talk today is: “Meeting the Global Challenge: The Role of Islamic Economics”. The subject is very vast and it is not possible for me to cover even all the most important aspects of this vast subject in a brief talk of about 35 to 40 minutes. However, I will try to do my best.

**THE GLOBAL CHALLENGES**

The first question that this subject raises is about the global challenges: what are these challenges that we are faced with? One of the most important of these challenges is to promote global harmony and integration. This we discussed yesterday. We talked about the globalization of mankind and integration of different economies around the world in a way that would help accelerate the development of all countries in an equitable manner. A second challenge lies in using efficiently and equitably the scarce resources at our disposal to eliminate poverty, fulfill the needs of all, minimize unemployment and inequalities of income and wealth, and ensure economic and financial stability. A third important challenge is to use effectively all human institutions, including the market, the family, the society, and the government in an integrated manner, to not only promote economic development and social harmony but also minimize crime, tensions and anomie.

## CONVENTIONAL ECONOMICS AND ITS DRAWBACKS

The question that you may ask at this point is whether conventional economics is not sufficient to meet these challenges. Well! When Mr. Tanaka asked me before the start of this session that, if there can be Islamic Economics, why can't there be Confucius Economics. My reply was: why not? The reason is that the challenges facing mankind are so great that, the greater the contribution from different sections of mankind, the greater may be our success in meeting these challenges. The Far Eastern countries are as capable of making valuable contributions toward the solution of human problems as are the Western countries.

The reason why Conventional Economics is by itself unable to meet the challenges is that its secularist approach has created a number of drawbacks. One of these drawbacks is its excessive emphasis on materialism, value neutrality, and the freedom of individuals to serve their self-interest and maximize their wealth and want satisfaction. If there are no moral constraints on individual freedom and individuals are free to serve their self-interest in accordance with their unhindered tastes and preferences, then what about social interest, how will it be served? The answer given by Conventional Economics is that social interest will be served automatically by competition. This has, however, not proved to be effective. Even though the role of competition in the economy cannot be denied, it is by itself not sufficient to safeguard social interest. This is because perfectly competitive markets are an unrealized dream and are likely to remain so. There are a number of clandestine ways of thwarting competition and the efficient operation of market forces. It is, therefore, necessary to have some other mechanism to complement, the role of competition in serving social interest.

Another drawback of Conventional Economics is that it concentrates only on economic variables. It neglects the role that moral, psychological, social, political, and historical factors can play in influencing human behaviour. The argument given for neglecting the role of these factors is that they are not quantifiable and require value judgments, which are an anathema to economics. Even though these variables involve value judgments and are not quantifiable, they are nevertheless crucial for the realization of socio-economic goals and cannot be ignored. Human behaviour is not influenced primarily by market forces and the price mechanism, it is also influenced by a number of other factors. The result of this attitude of Conventional Economics is that it does not recognize the role

that moral values can play in the efficient and equitable allocation and distribution of resources. It argues that prices determined by the market forces of supply and demand are by themselves sufficient to allocate resources efficiently. Conventional economists do not generally discuss equity; it is assumed that, if efficiency is realized, equity will also be automatically realized. Experience has led a number of economists to emphasize the need to take into account a number of other factors, including moral, psychological, social, political and historical. Ibn Khaldun, emphasized this forcefully 600 years ago. He formulated a model, which incorporated all these variables into economics. Consequently, he was able to provide better analysis in economics.<sup>1</sup>

As a result of the excessive emphasis on maximizing wealth and want satisfaction, one of the primary goals of economics has become the promotion of more and more consumption. This has led to living beyond means by both the public and the private sector all over the world. Consequently, there has been a phenomenal rise in debt. Even the United States, the richest country in the world, has become the most indebted country. If you add the indebtedness of the public sector, which includes the Federal government, the states, and the Municipalities, as well as that of corporations, businesses and individuals, the total US debt comes to about 37 trillion dollars or \$128,560 per person.<sup>2</sup> This is, of course, unsustainable and may lead to a breakdown of the financial system. It is difficult to predict when this may happen. However, sometime or the other, there is likely to be a crisis in the international financial markets as a result of this high level of indebtedness. In spite of this living beyond means and phenomenal rise in debt not only in the US but also in other countries, the distressing reality is that, while there are some people who are able to consume a lot, there are a large number of others who are unable even to satisfy their essential needs.

A third drawback of Conventional Economics is that, while it has emphasized the role of the market, the role of a number of human institutions like the family, the society and the government has generally been ignored. The entire emphasis of Conventional Economics is on the market. There is no doubt that the market is important. However, while it may be possible for the market to operate effectively on the basis of self-interest,

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<sup>1</sup> For details of this model, see Chapra, 2000, pp.145-17.

<sup>2</sup> Hodgson, 2004.

is it possible for the other human institutions also do the same? What about the family? Can a family operate effectively when the husband and wife both try to serve just their self-interest? A harmonious family requires both the husband and the wife to sacrifice not only for each other but also for their children. So, why is there so much emphasis on self-interest and not on sacrifice. If the husband and wife are not willing to sacrifice for each other, the family may disintegrate and the upbringing of children may suffer. If the family designates and the quality of the future generation declines, what will happen to the other institutions, the market, the society and the government? Since the human input for all of these institutions comes from the family, will they be able to operate effectively? If not, then how will we be able to meet the challenges that we face? So, why do we overemphasize the servicing of self-interest to such a great extent.

### **CAN ISLAMIC ECONOMICS HELP REMOVE THESE DRAWBACKS?**

This takes us to the crucial question of what programme does Islam have to safeguard social interest. Will it prevent the serving of self-interest? Will it reject the role of market mechanism? The answer to both these questions is No. Islam does not deny the useful role that the serving of self-interest and the market mechanism play in promoting efficiency and economic development. Communism tried to do away with these. The slogan was: “from each according to his ability to each according to his need.” This slogan did not work and the system failed. So the market mechanism and the serving self-interest have been reintroduced even in the Communist system. So if both these factors are going to be retained even by Islam, then how will Islam ensure the serving of social interest?

Islam, like other major religions, tries to motivate individuals to keep their self-interest within the bounds of social interest. This would naturally require some sort of a sacrifice on the part of all individuals operating in the market place. The crucial question that this raises is why will a rational person sacrifice his/her self-interest for the sake of others. There are a number of ways of motivating them to do so, some of them are recognized even by Conventional Economics.



One of these is competition, which is an essential ingredient of market mechanism. If a producer does not ensure good quality at a competitive price, he will suffer losses and will ultimately be thrown out of the market. Every producer in a competitive framework is, therefore, under a constraint to reduce cost and to improve quality if he wishes to earn a reasonable rate of profit and to stay in business. This helps keep self-interest under check.

Another way of keeping self-interest under check is social control. If a person tries to serve only his self-interest and hurts social interest by cheating, committing fraud, and not helping other people, he may not only be frowned upon but may also face social ostracization. If a person tries to show off and resorts to conspicuous consumption, he may invite social displeasure. This proved to be very effective in the early Muslim society and has also proved to be effective recently in Japan. There is a saying in Japan that 'The nail that sticks out the most, gets hit the hardest'. Anyone who tries to show off will be looked down upon. One of the reasons for the success of Japanese society was the social norm of leading relatively simple life. This norm does not perhaps prevail any longer. However, in the early days of Japanese development, this was extremely important. It was one of the reasons why Japan was able to save as much as 35% of its GDP. Consequently, Japan was able to develop without depending on foreign aid. It did not even have to borrow excessively from other countries. And this is true even of the Asian tigers. The saving rate is 35% even in Malaysia. China has a saving rate of 42%. Such a country is able to promote its own development without depending on other countries. Pakistan is very unfortunate in this respect. We have promoted living beyond means by both the public and private sectors in clear violation of Islamic norms. Consequently, the rate of saving in Pakistan is very low. With low rates of both saving and literacy, we cherish the dream of becoming an Asian tiger. This is not going to work. Thus market mechanism and social ostracization are both necessary for realizing social goals.

Good governance along with proper regulation and supervision is also extremely important. Conventional Economics in its earlier stages emphasized *laissez faire*, which

stood for zero government. Best government was considered to be zero government. Experience has proved that this concept was flawed. It does not, therefore, exist any longer. Everyone now talks of good governance, which requires a certain degree of regulation and supervision along with the provision of services that the economy needs for its better performance. It is also recognized that the government should also play a certain degree of welfare role to reduce the misery of those who are underprivileged.

In addition to these methods of keeping self-interest within the bounds of social interest, one other very important way by which Islam as well as other major religions try to ensure social interest is the injection of a moral dimension into economics. Moral values are intended to regulate human behaviour in a way that would help ensure social interest. Moral values were brought by all messengers of God. These messengers were sent by God to all people at different times.<sup>3</sup> A new messenger came when the teachings of a previous messenger were either lost or distorted. It was the continuation of a process that started with Adam himself. According to a weak *hadith* of the Prophet (pbuh), one hundred and twenty four thousand Messengers have been sent by God to all countries at different times in history. The Qur'an has mentioned the names of only twenty-five of them.<sup>4</sup> And who knows, Confucius, Krishna and Gautama Buddha, whose names are not mentioned in the Qur'an, may also have been Messengers of God. An indicator of such a large number of Messengers to different people is that there is a great deal of similarity in the values of all countries around the world, including Japan, China and India as well as the Middle East and the Western world. This is because most of these values have come from the same source: God's Messengers. One of these values is about simple living and avoiding conspicuous consumption. To assume that just market forces and the serving of self-interest will by themselves help us allocate and distribute resources in a way that could serve self-interest as well as social interest is highly unrealistic. There can be no escape from injecting a moral dimension into economics.

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<sup>3</sup> The Qur'an states clearly that: "And indeed We have sent Our Messengers to every community in every period" (al-Qur'an, 16: 30). "And We sent Messengers before you: some of them We have mentioned to you while some others We have not mentioned: (al-Qur'an, 40:78). It however, does not make any mention of the Prophets sent by God to people other than those in the Middle East. Their names were not familiar to them and the Qur'an is not intended to be an encyclopedia.

<sup>4</sup> Cited by Mawdudi (1962) in his commentary of verse 51 of *surah* 19, vol. 3, p. 72.

## IMPLICATIONS OF THE MORAL DIMENSION

This brings us to another question of what do we mean by injecting a moral dimension into economics. Moral values put certain constraints on the way a person earns his wealth and the manner in which he spends it. He must earn it without resorting to cunning, lies, cheating, fraud, bribery, corruption and exploitation of others. While he is free to spend his wealth to fulfill the needs of his own self as well as his family, he cannot waste it or squander it on status symbols and conspicuous consumption. Moral values require that before coming to the market, the individual should pass his wants through the moral filter. Should I buy this thing or not? I have money and I can afford to buy it, but should I buy it? What will be my reply to God on the Day of Judgment when I am asked this question about how I earned my wealth and how I spent it?<sup>5</sup> The price mechanism is by itself unable to inject such a discipline. Without the restraint of moral values, the rich can buy luxury goods and services even when the price of these is high. It is the poor who suffer because the excessive purchases of luxury goods by the rich deprives them of their need fulfillment.

Moral values thus impose certain obligations. Even Conventional Economics recognizes that the resources that a society has at its disposal are relatively scarce. Consequently, if some people acquire them excessively through wrong means and spend too much on luxury goods, then the resources available for meeting the needs of other people will be less. Such wasteful spending will also reduce saving and, thereby, lead to a

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<sup>5</sup> An oft-quoted *hadith* of the Prophet (pbuh) is: "A person will not be able to move on the Day of Judgment until he has been asked four questions about:

1. His knowledge, how much he acted upon it; "
2. His time, how he used it;
3. His wealth, how he acquired it and where he spent it; and
4. His body, how he exhausted it (cited by Abu Yusuf (d.798) (1352AH), p. 4.

لا تزول قدما عبد يوم القيامة حتى يسأل عن أربع : عن عمله ما عمل فيه ، وعن عمره فيما أفناه ، وعن ماله من أين اكتسبه وفيما أنفقه ، وعن جسده فيما أبلاه ( أبو يوسف ، كتاب الخراج ، ص 4 )

decline in investment and the opportunities available for employment. A number of people may get unemployed as a result of this and many families may suffer. This unemployment may also lead to crime and anomie. All these things are thus related to each other in a circular fashion.

Japan, where the saving rate was high, was able to pursue development without resorting to excessive borrowing. However, in Pakistan, conspicuous consumption is great and the saving rate is low. In a speech that President Musharraf delivered at the OIC Summit Conference in Kuala Lumpur on 15 October 2003, he said that 66% of Pakistan's budget goes to debt servicing. This means that only 34% is left for other public expenditures. As a result, Pakistan is unable to spend adequately on nation-building activities like education, health, infrastructure construction, and rural and urban development. Our universities, schools and colleges are unable to get the resources they need to improve the quality of education. Our health services are poor. And infrastructure is not able to expand with the needs of development.

Therefore, the injection of a moral dimension into economics is extremely important. This would make people pass their wants through two layers of filters. The first layer would be the moral filter. Before even going to the market, a number of claims on resources would get eliminated. The second filter, the price mechanism, would then come into action. The equilibrium that would then be established would tend to be in harmony with the humanitarian goals of society. The equilibrium that Conventional Economics discusses is not of this kind. It is concerned with the equality of demand and supply. Every market equilibrium is considered to be Pareto optimum. Conventional Economics does not ask whether this equilibrium is in harmony with social goals.

However, if you introduce a moral filter, every market equilibrium may not necessarily be acceptable. Only that equilibrium will be acceptable which is in conformity with the humanitarian goals of society. Such an equilibrium can be realized only if we pass all our claims on resources through the moral filter before going to the market and being exposed to the price filter. The two filters should together be able to help in not only making demand and supply equal but also in realizing the humanitarian

goals of society. The decline in demand for wasteful and conspicuous consumption goods should release resources for need fulfillment and investment. Consequently, prices of need-fulfilling goods may also be lower because of their greater supply.

Living beyond means has also led to monetary expansion and inflationary pressures. When I was a college student in the early 1950s, the salary of about 350-400 Rupees that a college professor used to get was sufficient to enable him to lead a comfortable life. Now it is not possible to lead such a comfortable life even in 100 times that amount. So they are forced to give tuitions and to earn through other part-time activities. The result is that they are unable to give enough attention to their students. Living beyond means has, therefore, raised inflationary pressures, increased the debt-servicing burden in many countries, and reduced the availability of need fulfilling goods and services.

Islam has another way of helping the fulfillment of needs. This is its social self-help programme through the institution of *Zakat*. You may say here that welfare states around the world spend much more than what *Zakat* probably might bring in. This is not right. We should compare *Zakat* proceeds, not with the expenditure of the government in other countries, but rather with private sector contributions to charity. A team led by Lester Salamon of Johns Hopkins University found that private giving has varied in developed countries in the second half of the 1990s from around 1 percent of GDP in the United States to less than 0.1% in Italy.<sup>6</sup> Compared with this, *Zakat* is at the rate of 2.5% of net worth. According to a number of studies, it may contribute as much as 1.8-4.3 percent of GDP.<sup>7</sup> This institution is now having a revival in the Muslim world and more and more Muslims have started paying *Zakat*. This should help raise *Zakat* revenues from their existing low levels and help considerably in improving the condition of the poor.<sup>8</sup> In many countries, the welfare state is now facing a crisis and is being rolled back because the financial burden that it has imposed on the state is too much for it to bear. In spite of a

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<sup>6</sup> *The Economist*, 31 July 2004, p. 46.

<sup>7</sup> Kahf, 1989; and Ahmed, 2004, p. 69.

<sup>8</sup> See Kahf, 1993; and Salama, 1982. See also Ahmed, 2004, p.71.

very high rate of taxation, more than 50 percent of GDP in some countries, the budgetary deficits have grown substantially.

To avoid this excessive pressure on the state, Islam has adopted the social self-help route. The state has to share the burden to a certain extent, but not the entire burden. Families and the society must together share a significant part of the burden. Why should the burden of my parents and my children be borne by the taxpayers and the state? It is my duty to take care of them. I cannot use *Zakat* money for this purpose. *Zakat* is meant to take care of the needs of other people who are not my direct responsibility. Islam has, thus, adopted the welfare state mechanism, but in a different way. The Islamic state must do a number of things that a welfare state does. However, the society and the family must share the burden substantially. It may, thus, be possible to meet the needs of the people without putting too much burden on the state.

## **CHANGES TAKING PLACE IN CONVENTIONAL ECONOMICS**

Changes are, however, now taking place in Conventional Economics. Firstly, a multi-dimensional approach is gradually becoming accepted. Economists have now started introducing social, institutional, political, psychological and other variables in their analysis, something that Ibn Khaldun did about 600 years ago. Secondly, in spite of the persistence of the secular philosophy on the part of the discipline as a whole, the injection of a moral dimension into economics is being emphasized by a number of even renowned economists. It is being increasingly realized that allocation and distribution of resources is not determined by just prices. It is also determined by moral values which have a considerable influence on human behaviour in general and on tastes and preferences in particular. Prof. Amartya Sen, a Nobel Laureate says in his book, *On Ethics and Economics* (1987), that “**the distancing of economics from ethics** has impoverished Welfare Economics and also weakened the basis of a good deal of descriptive and predictive economics”. His conclusion is that economics “can be made more productive by paying greater and more explicit attention to ethical considerations that shaped human behaviour and judgment” (Pp.78 and 79). An extremely valuable article by Hausman and McPherson published in the *Journal of Economic Literature* on “Economics and Contemporary Moral Philosophy”, concludes

that “An economy that is engaged actively and self-critically with the moral aspects of its subject matter cannot help but be more interesting, more illuminating, and ultimately more useful than one that tries not to be” (1993, p.723).

The welfare state, as I indicated earlier, is also being rolled back because experience has shown that it is not possible for the government by itself to take care of all the needs of individuals in society. Any effort to do so is bound to put a heavy pressure on the government budget and lead to fiscal deficits and inflationary pressures. If the welfare state is rolled back, then who is going to take care of the needs of the poor and underprivileged? Even before the rolling back of the welfare state, there were a number of people who did not fall into the welfare net. Now there will be even more. How can a society meet the needs of such people? Islam has introduced the institution of *Zakat* for this purpose. *Zakat* need not to be spent only for meeting the basic needs of the poor and handicapped. It should also be used to enable them to stand on their own feet through education and the provision of seed finance for promoting self-employment.

## **GLOBAL HARMONY AND INTEGRATION .**

Coming back now to our first question about promoting global harmony and integration, we saw yesterday that injection of the moral dimension in the society and economy around the world can make a valuable contribution to the promotion of global harmony and integration. If every country tries to serve its own self-interest, then what is going to happen? The same thing that the US did in Iraq? Bombing a country to control its oil resources and to use the oil income of that country to get contracts for rebuilding what has been purposely and ruthlessly destroyed.

The emphasis now being placed on promoting development of all countries to eliminate poverty, minimize unemployment is highly well-come. However, the saving rate around the world has gone down substantially in every country, the developed as well as developing. I do not mean to say that the decline in the rate of saving is the only cause of unemployment. It is, however, one of the important causes of unemployment. If the rate of saving goes up, it may be possible to boost investment without generating -

inflationary pressures. This should help all countries around the world raise employment, and minimize crime, tension and anomie. It is the moral dimension which can help us achieve this. If we continue with the prevailing excessive emphasis on the serving of self-interest and ignore the role of moral values in the allocation and distribution of resources, then crime, tension and anomie will tend to rise and rise continuously.

The injection of a moral dimension is also extremely important for promoting family and social harmony. Without this, as I indicated earlier, even the market, the society, and the government cannot operate effectively. If the family members are not willing to sacrifice for each other, the family cannot remain integrated. You can see this happening in the Western world, significantly more than in other countries. Francis Fukuyama refers to this phenomenon as the ‘great disruption’ in his book *The End of Order* (1997). If families become disintegrated, then the children are unable to get the love and affection and the kind of upbringing that both the parents can together provide to their children. Statistics indicate that children from broken families are unable to complete school and, if they do complete school, they are unable to complete college and university. So, if the quality of the human element goes down in any society, that society may not be able to make a significant advance in development, leave alone its desire to attain or maintain supremacy in the fields of science and technology.

In conclusion, I must emphasize that a number factors, including economic, moral, social, psychological, political, and historical, influence allocation and distribution of resources, which is the main concern of economics. It is, therefore, a mistake to take into account only the economic variables and to ignore the others. Of all these variables, the moral dimension is of particular importance because of its considerable influence on human behaviour in general and tastes and preferences in particular. If the well-being of all human beings is desired in spite of the relative scarcity of resources, then there is no other option available except to inject a moral dimension into economics and also to adopt a multidisciplinary analysis. The prevailing secular approach along with the emphasis primarily only on economic variables may not help us realize the goal of ensuring the well-being of all. This includes the well-being of even animals, birds and insects. These



constitute an essential part of a healthy environment and taking care of them is essential for realizing human well-being.

. THANK YOU.

### **QUESTIONS & ANSWERS SESSION:**

**Q.** You have talked about the inefficient and inequitable allocation of resources. However, in every market economy around the world, including that in Pakistan, banks are the major or almost the exclusive source of both savings and borrowing. We deposit our savings with them and we borrow from them. Banks are allowed to lend money on the basis of interest without any relevance to social ability or moral dimension of the projects financed by loans. So is it really feasible that, as long as the banks are free and not under government control or nationalized, they will lend money on the basis of the moral dimension of a project or its social utility.

Moreover, what about decline in the value of money. If a person lends money and receives payment after a few years, inflation may have eroded the real value of money substantially.

**Ans:** You have asked two questions. The first one is about how to ensure the productive use of funds that banks mobilize from the public through deposits. You seem to hold of the view that unless the banks are nationalized, it may not be possible to ensure the productive use of funds. Your second question is about the permissibility of indexation of loans and deposits. Both the questions you have posed are related to the last lecture of this series. I do not, therefore, see the need to go into this subject now because it is not possible to answer these questions without first explaining the nature of Islamic finance. Nevertheless, I will try to answer them briefly.

Nationalization of banks has generally proved to be a disaster. It has led to an increase in corruption. Loans have tended to be given to cronies as a result of political pressure. Appointments have also been made on the basis of favouritism. Consequently

these banks have generally been not only inefficient but also inequitable. Hence, there has been a movement towards privatization in almost every country.

What needs to be done in place of nationalization of banks is to introduce greater discipline into the financial system and to have better regulation and supervision. While regulation and supervision are now receiving considerable emphasis, the question of introducing greater discipline is not receiving as much attention as it should. Islamic finance should help inject this discipline. Profit and loss sharing should help make banks more careful in lending. Credit for financing speculation would become discouraged. Investment depositors would also be motivated to carefully watch the operations of their banks and demand better management and greater transparency. Moreover, since Islamic finance would make credit available largely for the purchase of real goods and services, credit expansion would tend to be in step with the growth of the economy.

As far as indexation of deposits and loans is concerned, there is difference of opinion among the scholars. Some are inclined towards its legitimacy while the majority is against it. They argue that it will open the backdoor to interest. They also argue that inflation is a monetary phenomenon resulting from excessive credit expansion. The solution, according to them, lies in controlling credit expansion and excessive claims on resources. The profit-and-loss sharing system should help reduce excessive credit expansion to both the public and private sectors by introducing greater discipline in the financial system. In addition, if the demand for conspicuous consumption goods and speculation is also curtailed by means of moral education and proper banking regulation and supervision, then it should be possible to control inflationary pressures.

**Q.** The high rate of saving in Japan was possible because Japan did not have to spend on its defence. Being under the control of the occupation authorities, Japanese defence was not the responsibility of Japan. This raises the question of how can countries whose defence is not the responsibility of some other country realize Japan's rate of saving.

**Ans:** (by Mr. Tanaka) I should be the one to answer your question. First of all Japanese high rate of saving is not the matter of recent past, it has been so for 150 years since 19<sup>th</sup>

century when we opened up our country to the West. Our rate of saving has been about 20%, I do not think it is 35%, and it is very high for that matter. And as you would recall before World War II, Japan was a military state and yet we maintained a high rate of saving. After World War II, we became passive and yet continued to maintain a high rate of defense spending. It does not matter whether we rely on the United State for this. We have perhaps the fourth largest military expenditure in the world in spite of being a passive country.

The high rate of saving has contributed to Japan's accelerated development. We financed our development projects ourselves by saving. Nevertheless, our saving was not enough and we borrowed from outside. For example after World War II, we borrowed from the World Bank as late as 1960s, but we repaid completely in 1968 or 69. So, this foreign borrowing at the public level had been there. Of course in the private sector we have lent and borrowed. So, there has been a lot of lending and borrowing, depending on which bank you are talking about. Now we have lent money to the United States. Japan is now by far the largest creditor in the world.. The consumers in rich countries enjoy their level of living because Japanese people lend them money to do that. That is why the East Asian financial crisis did not affect Japan. Korea and other countries suffered a lot because they borrowed heavily in the international market. Once the money they had borrowed fled from these countries, they did not know what to do.

However, it is not only saving that really helped Japanese development. There is another factor also. Industry and technology have also played a role in achieving perfection in manufacturing. This, along with work ethics, very little corruption and group cohesion, all helped in the 19<sup>th</sup> century, even prior to the military administration. Japan adopted basically the capitalist economy and made it our own. The perfection was already exercised prior to the opening of our country in the 19<sup>th</sup> century. So, while money is important, effective working ethics are also important. It is also important to have security of property. These were clearly defined when we got into the modern world.

We went through the feudalistic system. In Pakistan I have heard the word 'feudalism', but I do not think the word feudalism as it is used here is correct. In my

sense and perhaps also in the European sense, feudalism has layers of society defined in terms of authority or devotion. You have your rights and obligations clearly defined depending on the layer you are in. Here in this country the layers of the society are much more simple. There are not really so many layers in between. In Japan we have a lot layers of individuals and group of individuals piling up and increasing. Their duties, obligations and rights are clearly defined. Therefore, the corruption rate has been naturally kept very low because corruption is way to get around this layer. So, working ethics are very important in the Japanese case. In other countries I do not know, but certainly in Europe we found very similar feudalistic system which we built in the past and which helped our modern society to adopt this capitalistic or market economy system. The finance aspect is also important in addition to technology, social structure, and working ethics for making development possible. THANK YOU.

**Answer by Dr. Chapra:** The difference between 20% and 35% saving is due to net saving and gross saving. If you take depreciation away from the gross saving of 35%, the net saving is around 20%. Work ethics, less corruption, group solidarity, these are of course the teachings of Islam as well. Other religious also have work ethics as all Messengers of God have given these to their societies. Prophet Muhammad (pbuh) said: “ **إن الله يحب إذا عمل أحدكم عملاً أن يتقنه** ” (God loves that when any of you does something he does it in the best way”.<sup>9</sup> Therefore, cheating, going late to office, not working conscientiously, and not doing a good job are of course not in harmony with the value system of Islam.

Corruption is also condemned by Islam. It is one of the wrong ways of earning specified by the Qur'an and the *Sunnah*. The Qur'an clearly states: “ **ولا تأكلوا أموالكم بينكم ولا تأكلوا أموالكم بالباطل** ” (Do not eat each other's wealth in a wrong way) (2:188) Living beyond means, which has been encouraged in our society, is one of the things that induces a person to resort to corruption to find the resources to cover his excessive spending. If a person spends far more on his

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<sup>9</sup> Cited on the authority of Bayhaqi's *Shu'ab al-Iman* by Jalal al-Din al-Suyuti, in his *al-Jami' al-Saghir* under *Inn Allaha*, vol.1, p. 75.

children's wedding than what he can afford, then where is the difference going to come from? He will take bribes and cheat and resort to all different ways of getting money, irrespective of whether they are right or wrong. Group solidarity is also one of the basic teachings of Islam, as I indicated in my lecture yesterday. Japan lives up to its values and our problem is that we do not live up to our values. One of the reasons for this is our faulty education system. It does not provide the students with the kind of education in moral values that the society needs.

**Q.** (by Mr. Tanaka) I have a couple of questions that are just normal for me as an Ambassador, something about Japanese society. I think that one of the aspects of success of Japan is not to make population growth fast. Let us say one thing: in the Islamic world the population grows very fast. I think that this is really a global challenge. Pakistan is now taking off economically, everyone in the world can see that. But at the same time the growth of population is very fast. So, the challenge is the conflict between development and the growth of population. I would ask Dr. Chapra, about the best way to reduce this kind of fast growth of population, just by Islamic diction, by education, or by economic punishment. We all know China has done something for family planning but I would not say that it is a very successful way. If we do not have enough effective measures to reduce the fast growth of population, then it will slow down the process of development and also the fruits of development. Thank you.

**Ans:** As far as Islam is concerned some of our Ulama have opposed birth control but there are a number of others who do not do so. Birth control has been adopted by individuals in accordance with their needs. There is nothing wrong in this.

There is no doubt that Japan successfully controlled the growth of its population. However, the result is now being seen. The ratio of old people in the population has risen. This has two adverse consequences. Firstly, the pension system is in trouble and secondly, the labour force is not growing as fast as the economy needs. Ultimately wages will rise and reduce Japan's competitiveness if it does not import labour from abroad. China also imposed certain limits on child birth. However, because people wanted to have male children rather than female, they resorted to abortion if a female's child was

going to be born. Consequently the female population is much smaller, and this will create problems for society. Nature has its own way of creating a balance. You can see that throughout human history, the birth of boys and girls has been more or less in equilibrium. This is how God operates. When we try to disturb this mechanism then we create problems for ourselves. Therefore, when we try to promote birth control, we must bear in mind that pushing it too hard can also lead to difficult problems. The best thing to do is not to force individuals to resort to birth control. Let them do what they feel is right for them according to their circumstances. This may help create a balanced growth in population.

**Comment:** Just a quick comment! You all know that the best birth control mechanism in the world is female education. In Japan one of the best ways of promoting saving has proved to be control on consumption. My friends from Japan and North America tell me all the time that it is cheaper to buy Japanese goods in America and Canada than in Japan. So, they have a very good way of controlling consumption. This is something that we should also consider. Yesterday globalization was something to be adopted. However, today it gives us a warning that this capitalist dual system is going for major correction. When this correction will occur, I do not know. On the other hand, I would like in this forum some time in the future, may be not today, to see what Islam has to offer, specially the *Zakat* and *'Ushr* systems. As a layman I think this is the best way to have control over growth in a society and to ensure that the society has a mechanism of checks and balances.

**Q.** Today I will ask more questions. The engine of economic growth in what you call conventional economics today, may be in the fields of manufacturing, services, entertainment, and consumption. Where does Islam stand in the area of consumption as the engine of growth?

**Ans:** Consumption is absolutely necessary. However, it depends on what you are consuming, If too much of luxury goods are being consumed by the rich then the resources that remain for the need fulfillment of the poor are automatically less. So, if we reduce the consumption of luxury goods, it does not mean that consumption as a whole

would necessarily go down. There will be greater consumption of need-fulfilling goods, this will create greater solidarity and less tension in the society. This can provide incentive for greater efficiency in production, and ultimately lead to higher growth, higher saving and higher investment in the long run. So, when we emphasize less consumption of luxury goods, it does not mean we are talking of reducing aggregate consumption in the society. Consumption is going to be there. It is difficult to say what exactly will happen to aggregate consumption if we reduce the consumption of luxury goods by the rich and increase that of need-fulfilling goods by the poor. Aggregate consumption may rise, remain the same or fall. Whatever is required for need fulfillment has to be produced.

**Prof. Khurshid Ahmad:**

I think Mr. Chapra has responded to this question, I would like just to add a footnote to that. Consumption and useful consumption are not necessarily the same thing. Once we introduce the moral filter, consumption will remain but there will be a different mix of consumption. That is why you will see in the presentation that the emphasis is more on a shift from wants to needs. The difference between the two is that want is only what you produce commercially irrespective of its relationship to individual or group or social needs. For all these three layers of individual, group and society needs become more important. That is why there is the issue of useful consumption followed by useful production so that the consumption mix and production mix are more important and not disaggregated concept of consumption and production.

**Q.** I just begin with the question of meeting the global challenge. What is the purpose of changing Pakistani economics. It is necessary to educate our masses about how to deal with the global challenges. This is because the masses do not know what is useful consumption. We are just looking for ways to consume, more; we are not concerned about where the resources will come from. We do not know how to save. We do not have any system that would help educate the population to bring about the transformation from the old system to the new system. We have a very great system of *Zakat* but unfortunately we are ready to collect *Zakat* but we do not spend it for the well-being of the masses. It is

a great thing that we have the moral filter as well as price filter. However, the moral filter has almost vanished. So, I think, we need to educate our masses to face the global challenges. Plastic money is taking everything from us. We are ready to spend anything in Pakistan, but in return what are we giving to Pakistan. Our spending is not useful spending. Our spending is mostly on non-productive goods, therefore, I believe that educating the masses for productive spending is more important.

**Ans:** You are right. Educating the people about Islamic values is extremely important. However, this is not happening. We do not hear much about the moral values related to character building. There is greater emphasis on appearances and trivialities. Moreover, our banking system is also trying to push consumption through the easy availability of credit, particularly through credit cards. If this credit were made available for promoting self-employment through micro enterprises it might have been able to make a valuable contribution to development.

**Q.** Mr. Chapra I like to know little more about your observation that United States is the most indebted country in the world. On the basis of this it is quite often argued in Pakistan that we need foreign aid, because the U.S. is also borrowing all over the world. I think that borrowing of United States is quite different from the borrowing of other countries. Mr. Tanaka said Japan is the biggest creditor of United States. We are borrowing in quite a different way. Therefore, it is not fair to say that the United States is the most indebted country of the world. Capital is going to USA because it has the most productive use of capital. Therefore to think that the US will collapse because it is the most indebted country in the world. This, I think, is not fair.

**Ans:** Yes the money is coming to the United States. However, not all of it is going into productive investment. It is also boosting consumption. The US rate of saving is, thus, only about 1% or 2% of the GDP. Any country with such a low rate of saving cannot grow. The US is, nevertheless, able to grow because of the resources it gets from other countries. If outside savings stop coming or, worse than this, if there is a reverse flow to other countries, then the US Stock Market may decline. You can see that in recent years, the Dow Jones Average has gone down to about ten thousand as a result of substantial



reduction in the flow of savings from Europe and other countries. However if, instead of just a lower inflow, there were a net outflow from the US, then there would be serious trouble.

There is, a difference between the borrowing of Pakistan and the borrowing of the United States. US is the only country in the world which can settle payments by giving its IOUs to other countries. Other countries cannot do this. They have to make settlement through a decline in their net foreign assets. We need to bear in mind that the US can continue to issue IOUs as long as there is confidence in the US Dollar. If the confidence declines, then there will be a rise in US interest rates, a decline in the US stock market, and recession in the US economy. This will be bad for the whole world. This is not something hypothetical. It happened in the late sixties when the confidence in the Dollar declined. Consequently, there was a steep rise in gold and commodity prices and a great deal of instability in the international financial markets, which even the two-time devaluation of the Dollar and the second Amendment to the IMF Articles of Agreement could not help overcome.

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