

**Islamic Economics:**  
**The Solution to Income Inequality and Economic Instability**

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**Ahmadiyya Muslim Community** was established in 1889 by Hadhrat Mirza Ghulam Ahmad (1835-1908) in Qadian, India under divine guidance. He proclaimed himself to be the awaited Promised Messiah and Mahdi (reformer) whose advent was foretold by the Holy Qur'an (Islam's holiest scripture) and the Holy Prophet Muhammad (peace and blessings of Allah be upon him), as well as the awaited reformer foretold by all of the other great religions of the world. His stated mission was to convey to the world Islam's message of peace and love as presented in the Holy Qur'an and the Sunnah (traditions) of the Holy Prophet Muhammad (peace and blessings of Allah be upon him), as well as to re-present and revive the teachings of Islam in their uncorrupted and pristinely pure form. As prophesied by the Holy Prophet Muhammad (peace and blessings of Allah be upon him), after the passing away of Hadhrat Mirza Ghulam Ahmad in 1908, the Ahmadiyya Muslim Community re-established the institution of Khilafat (succession). The present Khalifa of the Worldwide Ahmadiyya Muslim Community is Hadhrat Mirza Masroor Ahmad, Khalifatul Masih V (may Allah continue to support him). Two notable members of the Ahmadiyya Muslim Community are the late Sir Zafrulla Khan, President of the International Court of Justice (1954-61) and the late Dr. Abdus Salam, recipient of the Nobel Prize for Physics (1979).

#### **ABOUT THE AUTHOR**

M. Nadeem Ahmad Siddiq received his Bachelor of Arts (Economics) from the University of Toronto, completed his Juris Doctor studies at the University of Minnesota and the University of Toronto, and received his Master of Laws from Osgoode Hall of York University. He is a former Managing Editor of the *Journal of Law & Inequality* (published by the University of Minnesota) and intern for the Special Rapporteur on Religious Intolerance at the United Nations Centre for Human Rights in Geneva, Switzerland. He has published papers on Islamic law as well as on the persecution of the Ahmadiyya Community in Pakistan, including the preparation of submissions to the United Nations, the United States Department of State and Canada's Parliamentary Committee on Human Rights. Currently, he lives in Toronto, Canada where he practices banking, structured finance and derivatives law representing one of Canada's chartered banks.

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## **1. Introduction**

For the past few decades, income disparity has been growing at an alarming pace. Indeed, the income disparities in existence today have not been seen since the 1920's, just prior to the Great Depression. As growing income disparity has always acted as a harbinger of economic downturn, the road to achieving economic stability and sustainability can only be achieved once the problem of income disparity and inequality is addressed. In so doing, I shall discuss the basic foundational principles of Islamic economics, both from an individual consumer perspective as well as from a legal and regulatory perspective.

According to the Islamic system of economics, while Islam seeks to ensure that the basic needs of all members of society are looked after, unlike Communism and Socialism, Islam advocates a capitalist economy<sup>1</sup> that encourages individual free enterprise such that the pursuit of wealth is not chagrined.<sup>2</sup> Indeed, the Holy Prophet Muhammad (sa) as well as his closest companions, including his wife, Hadhrat Khadija (ra) and his first and third Caliphs, Hadhrat Abu Bakr (ra) and Hadhrat Uthman (ra), respectively, were successful entrepreneurs and businesspeople. However, while Islam is capitalist<sup>3</sup>, the fundamental view espoused by some capitalist economists that "more is better" does not reflect the Islamic viewpoint. Further, the view according to some modes of religious thinking that wealth and prosperity are directly linked to the degree of one's divine favour or disfavour from God is also not the Islamic viewpoint. Although Islamic economics is capitalist, such capitalism is not free of morality and regulation.

In Islam, Muslim consumers must recognize that all ownership belongs to God and that their material possessions, or the lack thereof, serve merely as a trial for them in order to test their degree of trust in and gratefulness to Him as well as their level of goodness. Muslims are to live with modesty, shunning extravagance and the hoarding of wealth, and honouring the share of the poor in their wealth by giving in alms (*zakat*) and charity (*sadaqa*). Also, Islam promotes a moderately regulated commercial environment which promotes substantive justice (*adl* and *qist*) and prohibits economic exploitation (*riba*) in order to end the perpetuation of income disparity and poverty. When these core Islamic economic principles are put into practice, both on an individual and regulatory level, the amelioration of income disparity will ensue thereby resulting in economic sustainability and stability.

## **2. The Current Global Economic Crisis**

While we do not yet know the expected length or severity of the current economic downturn or whether we have yet to see its bottom, the current consensus is that it will likely be deep, far-ranging and long. On

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<sup>1</sup> For purposes of this paper, "capitalism" is an economic system in which property is largely privately-owned and in which profit provides the incentive for the investment of capital and the employment of labour. Also, it is the philosophy that the role of the government should be as limited as possible, perhaps strictly to public-interest regulation, allowing the market forces of supply and demand to behave relatively unfettered. Compared to other economic systems, capitalism is one which promotes the voluntary cooperation of individuals, as opposed to a central authority directing individuals through coercion, in order to direct production. In other words, it is the economic system which advocates the least amount of coercion on economic actors.

<sup>2</sup> See Hadrat Mirza Bashiruddin Mahmud Ahmad, *Nizam-e-Nau: New World Order of Islam* (Islam International Publications 2005); Hazrat Mirza Bashir-ud-din Mahmud Ahmad, *The Economic Structure of Islamic Society* (Nazir Dawat-o-Tabligh Ahmadiyya Community 1966).

<sup>3</sup> The economic activities of society are organized either through coercion or voluntary cooperation. Coercive systems include feudalism, socialism and communism and others) because they impose and direct production and redistribution upon society. The absence of coercion is capitalism which is an informal system of voluntary cooperation and activity. While the government's role is dominant in coercive systems, in capitalist systems, government's role is limited to safeguarding basic public interest concerns in order to ensure a stable society. As the Holy Qur'an 2:257 states, "There shall be no compulsion in matters of religion", the non-coercive and voluntary economic system of capitalism is consistent with Islam.

March 11, 2009, the International Monetary Fund declared that the world is in the grips of a “great recession”.<sup>4</sup> In response, governments are putting together massive stimulus packages in an attempt to soften the recession’s blow and to inspire the resurgence of the movement of money, either for banks to resume lending or for corporations and consumers to resume spending. However, lost in the discussions are the reasons why we find ourselves in these straits, and do so time and again, and how we can avoid such drastic and expensive stimulus measures (which may or may not be successful) in the future.

Throughout the world, particularly in the United States (“US”), Canada and the United Kingdom, during the 1980’s and 1990’s, the then stewards of our economy led us into a period of unprecedented de-regulation. The promise was that laissez-faire free-market capitalism would release us from the tyranny and suffocation of bureaucratic regulation. Those with wealth need not be answerable to government regulation as the democratic judgment of the markets would be sufficient.<sup>5</sup> The interests of the poor would eventually be looked after by a “trickling down” of economic prosperity thus resulting in improved income disparity over the long-run. However, history has proven that these promises have never materialized, but rather, our current economic culture has brought us to where income disparity continues to widen ushering in, time and again, painful periods of economic instability and downturn.

Taking the US as an example, the “ground zero” (so to speak) of the current global economic crisis, currently, 1% of its population possesses more than 40% of the world’s wealth and 10% of its population possesses more than 75%. That leaves less than 25% for the other 90% of the population, and this disparity continues to grow. Such disparities have not been witnessed since the 1920’s, immediately prior to the Great Depression of the 1930’s.<sup>6</sup>

To describe just how these income disparities have occurred, one need only look at the manner in which the income of the rich has dramatically increased relative to the wage of the average worker over the past few decades. For example, in the US, just prior to the 1990’s, the average Chief Executive Officer (“CEO”) earned approximately 85 times more than the average worker. However, by the end of the 1990’s, CEO’s earned more than 400-500 times more than the average worker.<sup>7</sup> While this was occurring, even though productivity was dramatically increasing, the average worker wage stayed largely the same and the windfall went to senior executives through salaries or bonuses, and to shareholders. During the 2008 presidential campaign, when Barack Obama raised the notion of raising the minimum wage, corporations raised an uproar alleging that such a move was akin to spurring inflation and would cripple the corporate ability to earn profits.

Since the 1990’s, at the expense of creativity, innovation and organic growth, the pace of mergers and acquisitions has been staggering with the large majority of such transactions producing lower shareholder value, lesser and more expensive products and services for consumers, as well as job losses. A few years ago in an opinion-editorial for the *Globe & Mail* newspaper, former Deputy Finance Minister and current Toronto-Dominion Bank Chief Economist, Don Drummond, noted that the beneficiaries of mergers and acquisitions, particularly between financial institutions, tend to be exclusively senior executives, who either give themselves hefty pay raises or generous severance packages with no benefit trickling down to

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<sup>4</sup> See *IMF sees an even deeper recession*, *Globe & Mail*, March 18, 2009, page B1.

<sup>5</sup> Laissez-faire capitalism was referred to as the true triumph of democracy. However, in contradiction to the hailing of democracy, whenever people have protested the negative effects of the free-market, such people have always been vilified and degraded to the point where they become discredited and unheard thus making the promise of honouring democracy hollow. How the media and the intelligentsia referred to the protestors at the World Trade Organization meetings in November 1999 in Seattle is an obvious example of this. In addition, when the World Bank and the International Monetary Fund threatened to hold back funds unless free-market reforms were adopted, and when the economies of countries like Argentina collapsed due to the adoption of these reforms, the laissez-faire advocates offered no apologies but simply shrugged and looked the other way.

<sup>6</sup> See Thomas Frank, *One Market Under God: Extreme Capitalism, Market Populism and the End of Economic Democracy* (Anchor 2001).

<sup>7</sup> The former CEO of General Electric, Jack Welch, was paid more than 1,400 times what the average worker in his own company made.

shareholders, consumers or employees. In other words, for the past few decades, the most wealthy senior executives have been making decisions that primarily benefit themselves at the expense of all others.

Our experience of the past few decades provides ample evidence that, when the free-market econometric models described by Adam Smith in his book *The Wealth of Nations* are employed, the result is always the exacerbation of income disparity and economic exploitation. In other words, when the stewards or “Masters” of our economy are left unchecked and unregulated, they will invariably make decisions that are exclusively in their own self-interest. The most obvious example of this is the recent use of hundreds of millions of dollars of public “bailout” funding to financial institutions to provide gargantuan bonuses to senior executives.<sup>8</sup> Indeed, in his book, Adam Smith admitted of the prevalence of this phenomenon.<sup>9</sup> The reason for this phenomenon is that the fundamental axiom espoused by some capitalist economists that “more is better” results in a consumerism and the absence of a regulatory framework that results in encouraging the pursuit of self-interest and the amassing of wealth as an end in itself with no regard to ameliorating the conditions of the poor and less fortunate. In addition, according to some modes of religious thinking (for example, Lutheran, Calvinistic and Hindu), one’s economic prosperity is directly linked with the degree of one’s divine favour, with poverty being a sign of divine disfavour. Therefore, any effort to ameliorate poverty constitutes interference with God’s divine will.<sup>10</sup> For Adam Smith, through His “Invisible Hand”, the free markets are the instrument through which God manifests His divine will.<sup>11</sup>

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<sup>8</sup> See *Economic Crisis: Obama vows to cut off AIG bonuses amid outrage*, Globe & Mail, March 17, 2009, A1. Quite recently, it has come to light that there exists a complete disconnect between executive compensation and merit or retention, the two primary reasons for the levels at which they are set. For example, millions of dollars are paid to executives who are no longer with the corporation (as in the case of AIG). Also, stock options are back-dated and re-priced and compensation packages are re-engineered solely to enhance executive pay regardless of merit. The blame for this phenomenon is placed on the composition of the boards of the corporation that set executive compensation. Some members of the board are also members of the executive while the independent members are nevertheless members of the executive of other corporations. The result is the formation of an “inner circle” of board members and executive management “all goring the same ox” so to speak. Ordinary investors who primarily own shares, directly or indirectly (through mutual or pension funds), have no ability to object to the appointments of such board members or to vote against them. They can only abstain from voting which cannot block their appointments.

<sup>9</sup> Adam Smith, *The Wealth of Nations*, p. 169 (Penguin, 1985) (“Masters are always and everywhere in a sort of tacit, but constant and uniform, combination, not to raise the wages of labour above their actual rate. To violate this combination is everywhere a most unpopular action, and a sort of reproach to a master among his neighbours and equals. We seldom indeed here of this combination, because it is the usual, and one may say, the natural state of things. . . . Masters, too, sometimes enter into particular combinations to sink the wages of labour even below this rate. These are always conducted with the utmost silence and secrecy, till the moment of execution. . . .”). Also see John Ralston Saul, *The Unconscious Civilization*, p. 81-82 (Anansi 1995).

<sup>10</sup> Corporations and free markets are often referred to as akin to God. In the words of popular social theorist George Gilder, the world is now run by “entrepreneurs who know the rules of the world and the laws of God.” For example, the title of Tom Peters’ seminal book is *The Market’s Will Be Done* (1992), a play on the Lord’s prayer phrase “Thy will be done”, and Kevin Kelly’s book entitled *Out of Control* (1994) delineates the “Nine Laws of God” to describe what he refers to as the rules of the “New Economy”. Further, two of America’s best-selling books are *God Wants You to Be Rich* (1995) and *Jesus, CEO* (1996).

<sup>11</sup> See *Genesis* 50:15-21 (referring to the “invisible hand” of God’s providence). In his book, Adam Smith used the term to refer to an individual pursuing his self-interest as being good for the human community. Adam Smith, *The Wealth of Nations*, Book IV (Penguin 1985). In addition, as many of the stewards of the economy (either as corporate or political leaders) may also be freemasons, allegations have been made that freemason ideology encourages income inequality and disparity in order to maintain the hegemony of its members in furtherance of their ultimate objective, being world dominance. Interestingly, Hadhrat Mirza Ghulam Ahmad (as), the Promised Messiah and Mahdi, and Founder of the Ahmadiyya Muslim Community received the following revelation from God regarding freemasons, “*freemasons hargiz tujh par musallat naheen keay jaingay* (“freemasons shall not overpower you”)” meaning their attempts at world domination will ultimately not achieve success.

Periods of increasing income disparity and inequality have always acted as harbingers of economic downturn and recession.<sup>12</sup> Intuitively, this correlation between income disparity and economic decline makes sense. When jolts to the economy occur, such as a dramatic spike in gas prices or escalating sub-prime mortgage defaults (which cause the collapse of the asset-backed commercial paper market thus rocking investor and consumer confidence), the consumption of 90% of the population possessing only 25% of the wealth is insufficient to sustain or stabilize the economy. Certainly, the consumption of the top 10% of the populations possessing 75% of the wealth, which is primarily spent on extravagance or is hoarded, is not capable of sustaining an entire economy.

Just as Smithian free-market capitalism's promise of the "trickle down" to improve income disparity has proved false, so too has its promise of producing economic stability and sustainability. Indeed, our experience has shown that unfettered free-market capitalism results in exacerbating income inequality thus leading to repeated periods of economic downturn and instability. Therefore, from the Islamic perspective, until such time as income disparity is addressed, the road to economic stability and sustainability cannot begin.

### 3. Islamic Economics – The Individual Consumer

On an individual consumer level, according to Islamic teaching, the current economic crisis has resulted because consumers have failed to recognize God and thus did not fulfill their individual moral and spiritual obligations to Him and to their fellow human beings with respect to their wealth. Contrary to Islamic teaching, rather than living with gratefulness and avoiding extravagance, consumers seek to amass wealth and live extravagantly or beyond their means while disregarding the interests of the less fortunate.

Remembering and recognizing God means recognizing that He possesses absolute dominion and ownership over all things such that, whatever we possess, has come directly from Him and Him alone. In the Holy Qur'an, God is referred to with reference to His 99 names or attributes, two of which are *Al-Wahaab* (the Provider of All Things) and *Al-Razzaq* (the Sustainer) such that it is God Who provides for us and then sustains us, both physically and spiritually. In the Holy Qur'an, God's ownership of all that exists in the heavens and earth is referred to more than 40 times. In addition, the Holy Qur'an asserts repeatedly that all provision and sustenance is from God alone. For example, the Holy Qur'an states,

"And blessed is He [Allah] to Whom belongs the kingdom of the heavens and the earth and all that is between them, and with Him is the knowledge of the Hour, and to Him shall you be brought back." (Holy Qur'an 43:86)

"Surely thy Lord enlarged His provision for whom He pleases, and straitens it from whom He pleases." (Holy Qur'an 17:31)

". . . And Allah bestows His sustenance on whomsoever He pleases without reckoning." (Holy Qur'an 2:213)

"It is Allah Who has created you, *and* then He has provided for you; then He will cause you to die, *and* then He will bring you to life. Is there any of your 'partners' who can do any of these things? Glorified be He and exalted above that which they associate *with Him*." (Holy Qur'an 30:41)

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<sup>12</sup> Andrew Leonard, *The Great Depression: The Sequel* (available at <http://www.salon.com/opinion/feature/2008/04/02/depression/index.html?%3Fsource=yahoo>); James R. Dunn PhD, *Are Widening Inequalities Making Canada Less Healthy?* (available at [www.making-connections.com](http://www.making-connections.com)); Stephen J. Dubner, *How Big of a Deal is Income Inequality?* *Guest Post*, Freakonomics, New York Times, August 27, 2008 (available at <http://freakonomics.blogs.nytimes.com/2008/08/27/how-big-of-a-deal-is-income-inequality-a-guest-blog/?apage=3>).

“Have they not seen that Allah enlarges the provision to whomsoever He pleases, and straitens it to whomsoever He pleases? In that truly are Signs for a people who believe.” (Holy Qur’an 30:38)

According to the Holy Qur’an, the state of our affairs, whether financial or otherwise, always serves as a test or trial for us. Whether we are rich or poor, in a state of enjoyment or calamity, we are in a constant state of trial whereby God seeks to test the degree of our trust in and our gratefulness to Him, as well as the extent of our good conduct. For example, the Holy Qur’an states,

“Said one who had knowledge of the book, . . . ‘This is of the grace of my Lord that He may try me whether I am grateful or ungrateful. And whosoever is grateful is grateful for the good of his own soul, but whosoever is ungrateful, truly My Lord is Self-Sufficient, Gracious.’” (Holy Qur’an 27:41)

“And He it is Who has made you successors of others on the earth and has exalted some of you over others in degrees of rank that He may try you by that which He has given you.” (Holy Qur’an 6:166)

“Verily, We have made all that is on the earth as its adornment so that We may try them as to which of them is best in conduct.” (Holy Qur’an 18:8)

“And strain not thine eyes over what We have bestowed on some classes of them of the splendour of the present world so that We may try them thereby. And the provision of Thy Lord is better and more lasting.” (Holy Qur’an 20:132)

“And we will try you with something of fear and hunger, and loss of wealth and lives and fruits, but give glad tidings to those who patiently persevere.” (Holy Qur’an 2:156)

“And in like manner have we tried some of them by others, that they may say, ‘Is it these [the poor] whom Allah has favoured from among us?’ Does not Allah know best those who are grateful?” (Holy Qur’an 6:54)

“And we will surely try you until We make manifest those among you who strive for the cause of Allah and those who are steadfast. And We will make known the true facts about you.” (47:32)

“Who has created death and life that He may try you as to which of you is best in deeds, and He is the Mighty, the Most Forgiving.” (Holy Qur’an 67:3)

“You shall be surely be tried in your possessions and in your persons . . . but if you show fortitude and act righteously, that indeed is a matter of strong determination.” (Holy Qur’an 3:187)

“And know that your possessions and your children are but a trial and that it is Allah with Whom there is great reward.” (Holy Qur’an 8:29)

“Wealth and children are adornments of the life of this world. But enduring good works are better in the sight of thy Lord in respect of immediate reward, and better in respect of future hope.” (Holy Qur’an 18:47)

O believers, let not your wealth and your children divert you from the remembrance of Allah. And whoever does so, it is they who are the losers.” (Holy Qur’an 63:10)

“Verily your wealth and your children are but a trial, but with Allah is an immense reward.” (Holy Qur’an 64:16)

In asking for God to provide for us, to sustain us and to protect us from calamity, the Holy Qur’an teaches humanity to put trust solely in God. For example, the Holy Qur’an states,

“If Allah helps you, none shall overcome you; but if He forsakes you, then who is there that can help you beside Him? In Allah, then, let the believers put their trust.” (Holy Qur’an 3:161)

“*True* believers are only those whose hearts tremble when *the name of* Allah is mentioned, and when His Signs are recited to them they increase their faith, and who put their trust in their Lord.” (Holy Qur’an 8:3)

“Say, ‘Nothing shall befall us save that which Allah has ordained for us. He is our Protector. And in Allah then should the believers put their trust.’” (Holy Qur’an 9:51)

“And whatever you have been given is only a temporary provision of this life, but that which is with Allah is better and more lasting for those who believe and put their trust in their Lord.” (Holy Qur’an 42:37)

When being provided for and sustained, humans are granted provision (*rizq*) directly from God. When being provided for, Muslims are free to and encouraged to consume the good things of the world, but must do so with moderation, shunning extravagance and being ever-grateful to God. Indeed, this is the basis for the prohibition of gambling and the consumption of alcohol.<sup>13</sup> For example, the Holy Qur’an states,

“Satan desires only to create enmity and hatred among you by means of wine and gambling, and to keep you away from the remembrance of Allah and from prayer. But will you keep back? . . . On those who believe and do good works there shall be no sin for what they eat, provided they fear *God* and believe and do good works, *and* again fear *God* and believe, yet again fear *God* and do good. And Allah loves those who do good. O believers! Allah will surely try you in a *little* matter: the game which your hands and your lances can reach, so that Allah may distinguish those who fear Him in secret. Whoso, therefore, will transgress after this shall have a grievous punishment.” (Holy Qur’an 5:92-95)

“So eat of the lawful and good things which Allah has provided for you; and be grateful for the bounty of Allah, if it is Him you worship.” (Holy Qur’an 16:115)

“If you are grateful, I will, surely, bestow more favours on you; but if you are ungrateful, then know that My punishment is severe indeed.” (Holy Qur’an 14:8)

“O children of Adam! Adorn yourselves at every time and place of worship, and eat and drink (freely), but be not immoderate, surely, He does not love those who are immoderate.” (Holy Qur’an 7:32)

“Until, when we seize those of them who indulge in extravagance with punishment, behold, they cry for help.” (Holy Qur’an 23:65)

“Why should Allah punish you if you are grateful and if you believe? And Allah is Appreciating, All-Knowing.” (Holy Qur’an 4:148)

Whenever a calamity or crisis befalls one, whether it be financial or otherwise, it is either in order to punish or to test us. However, in either case, the prescription is always the same. We must turn to God with complete trust in Him and with gratefulness to Him. Unlike some modes of religious thinking, the possession of wealth is not a sign of divine favour, but rather, may well be an indication of a state of ungratefulness which merits divine punishment, either in this life or in the Hereafter. For example, the Holy Qur’an states,

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<sup>13</sup> Indeed, the consumption of alcohol and gambling always result in exacerbating poverty. The rich indulge in consuming alcohol and gambling as leisure and extravagance. The poor in society seek wine and gambling in order to emulate the rich. Therefore, when the rich shun such activities, so too will the poor. See Hadrat Mirza Bashiruddin Mahmud Ahmad, *Nizam-e-Nau: New World Order of Islam* (Islam International Publications 2005).

“And when an affliction befalls men, they cry unto their Lord, turning to Him in repentance, then when He has made them taste of mercy from Him, lo, a section of them associate partners with their Lord so as to be ungrateful for what We have given them. So enjoy yourselves awhile, but soon you will come to know.” (Holy Qur’an 30:34-35)

According to this verse, a person living in a state of material enjoyment may well be someone who is condemned to divine punishment due to their ungratefulness. Indeed, according to the Holy Qur’an, very few people are grateful, leaving much of humanity, particularly those who are rich and wealthy, perhaps living in a constant state of ungratefulness and thus destined for divine retribution. For example, the Holy Qur’an states,

“And He gave you all that you wanted of Him; and if you try *to* count the favours of Allah, you will not be able to number them. Verily, man is very unjust, very ungrateful.” (Holy Qur’an 14:35)

“... but most men are ungrateful.” (Holy Qur’an 12:39)

The Holy Prophet Muhammad (sa) set for us an example of ideal gratefulness. For example, despite receiving assurance in the Holy Qur’an that God had forgiven him for all of his past and future shortcomings (Holy Qur’an 48:3), nevertheless, the Holy Prophet (sa) was so devoted to prayer that the act of performing his prayers would often cause his feet to become swollen. When he was asked why he remained so devoted to prayer given that all his shortcomings had already been forgiven, his simple answer was, “May I not prove myself to be Allah’s grateful servant?”<sup>14</sup>

In addition to living with moderation and shunning extravagance, Muslims also show their gratefulness by striving against greed and stinginess by avoiding the accumulation and hoarding of wealth. For example, the Holy Qur’an states,

“Fair-seeming to men is made the love of desired things, women and children, and hoarded heaps of gold and silver, and horses of mark and cattle and crops. That is the provision of the present life, but it is Allah with Whom is an excellent home.” (Holy Qur’an 3:14)

“Mutual rivalry in seeking increase in worldly possessions diverts you from God, til you reach your graves. Nay, you will soon come to know the truth.” (Holy Qur’an 102:2-4)

“Who amasses wealth and counts it over and over, he thinks that his wealth will make him immortal. Nay! He shall surely be cast into the crushing torment.” (Holy Qur’an 104:3-5)

“Say, ‘Even if you possessed the limitless treasures of the mercy of my Lord, you would surely hoard them for fear of exhausting them, for man is stingy.’” (Holy Qur’an 17:101)

“And those who hoard gold and silver and spend not in the way of Allah, give to them the tidings of a painful punishment. On the day when it shall be made hot in the fire of Hell, and their foreheads and their sides and their backs shall be branded therewith and it shall be said to them, ‘This is what you hoarded for yourselves, so now taste what you used to hoard.’” (Holy Qur’an 9:34-35)

“And keep not thy hand chained to thy neck out of stinginess, nor stretch it forth to its utmost limit out of extravagance, lest thou sit down blamed, exhausted.” (Holy Qur’an 17:30)

Indeed, in stark contrast to the system of primogeniture (which allows one to devise all of one’s estate to just one heir or a small few of them), the Islamic scheme of inheritance found in the Holy Qur’an at 2:181-183, 4:8-14, and 4:177 is imposed in order to ensure that wealth and property are not hoarded, but rather, are continuously broken up and divided amongst multiple heirs to be employed for the service of as many

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<sup>14</sup> Muslim 39:6772.

people as possible.<sup>15</sup> When inheritance rights to women were guaranteed for the first time in human history by the Holy Qur'an, widows and orphans (historically, the poorest classes in society) immediately broke out of the cycle of poverty which plagued them.

In addition to being grateful, living with moderation, and shunning hoarding and extravagance, Islam also grants a share of one's wealth to the poor and the needy. As our wealth is provided to us by God, our rights in it are not exclusive such that the poor and the needy also possess a claim over it. For example, the Holy Qur'an states,

"But when He tries him and straitens for him his means of subsistence, he says, 'My Lord has disgraced me.' Nay, but you honour not the orphan, and you urge not one another to feed the poor, and you devour the heritage of other people wholly, and you love wealth with exceeding love." (Holy Qur'an 89:18-21)

"And give to the kinsman his due, and to the poor and to the wayfarer, and squander not thy wealth extravagantly." (Holy Qur'an 17:27)

"And in their wealth was a share for those who begged and for those who could not." (Holy Qur'an 51:19)

"And those in whose wealth is a known right, for those who beg and for those who do not." (Holy Qur'an 70:25-26)

"So give to the kinsman his due, and to the needy, and to the wayfarer. That is best for those who seek the favour of Allah, and it is they who will prosper." (Holy Qur'an 30:39)

In order to honour the rights of the poor, not only are Muslims encouraged to contribute charitably in the form of *sadaqa*, but moreover, one of the five pillars of Islam is *zakat* (alms for the poor) whereby a Muslim pays a tithe based on the value of his or her assets.<sup>16</sup> In the Holy Qur'an, the term *sadaqa* is referred to 12 times.<sup>17</sup> *Zakat* is referred to over 30 times, 27 of which are in conjunction with the commandment to perform prayer (*salat*), thereby indicating its importance. *Zakat* is obligatory while *sadaqa* is voluntary. Indeed, giving *zakat* results in God blessing one's wealth and thus further increasing it. For example, the Holy Qur'an states,

"... but whosoever gives *zakat* seeking the favour of Allah, it is they who will increase their wealth manifold." (Holy Qur'an 30:40)

From a societal perspective, when the wealthy person employs his surplus for the service of the needy, he develops an affection for them and a concern for the amelioration of their plight. In addition, the recipients of his generosity, instead of despising him or coveting his wealth, they honour, admire and praise him. Therefore, living life with a charitable ethos not only lessens income disparity, but also fosters social peace and goodwill.

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<sup>15</sup> According to Hadhrat Musleh Maood (ra), the purchasing of large palatial homes and the acquisition of opulent jewellery collections is akin to hoarding. See Hazrat Mirza Bashir-ud-din Mahmud Ahmad, *The Economic Structure of Islamic Society* (Nazir Dawat-o-Tabligh Ahmadiyya Community 1966).

<sup>16</sup> See Holy Qur'an 2:44, 2:84, 2:111, 2:178, 2:274, 2:278, 4:78, 4:163, 5:13, 5:56, 7:157, 9:5, 9:11, 9:18, 9:60, 9:71, 9:103, 22:42, 22:79, 23:5, 24:38, 24:57, 27:4, 30:40, 31:5, 33:34, 41:8, 58:14, 73:21 and 98:6.

<sup>17</sup> Holy Qur'an, 2:197, 2:264, 2:272, 2:277, 4:115, 9:59, 9:61, 9:80, 9:104, 9:105, 58:13 and 58:14. In accordance with the book *Al-Wasiyyat* by Hadhrat Mirza Ghulam Ahmad (as), the Promised Messiah and Mahdi, and Founder of the Ahmadiyya Muslim Jama'at, members of this community who so subscribe pursuant to it commit to paying a tithe and donating 1/10<sup>th</sup> to 1/3<sup>rd</sup> of their income and property to be employed for the service Islamic propagation as well as the poor and the needy. When all citizens, rich or poor, make such a commitment, then ungratefulness, hoarding and extravagance are impossible in such a society.

In Islam, contrary to the fundamental axiom of Western capitalist economics, more is not necessarily better, and contrary to some modes of religious thinking, the degree of one's personal wealth is not to be viewed as an indication of the degree of one's divine favour. For Muslims, wealth and material possessions are not to be pursued as an end in itself and without due regard to moderation and the interests of the needy. Without stifling individual enterprise, Islam requires Muslims to be mindful of their moral obligations regarding their wealth, and of the fact that, ultimately, they will be answerable to God regarding its administration. From the Islamic perspective, the lessening of income disparity can only begin when individuals, at the consumer level, begin to acknowledge their moral responsibilities regarding their wealth and honour the rights of the poor in it accordingly.

#### **4. Islamic Economics -- Legal and Regulatory Foundations**

While the principles of individual consumerism as espoused by Islam, when adopted by individuals voluntarily, begin the road towards building a sustainable economy with decreasing income disparities, ultimately, this goal will only be achieved when the Islamic principles pertaining to the legal and regulatory framework of society are also implemented. As previously mentioned, Islam promotes a capitalistic system, but such a system is not completely laissez-faire or free-market in nature. Rather, Islam promotes a regulated capitalist economy in which government plays a role, albeit a non-dominant one. The following discussion is regarding the foundational principles of such a regulatory system. According to Islam, society must be founded upon on a public interest legal and regulatory system which encourages substantive justice and prohibits economic exploitation in order to end the perpetuation of poverty and thus income inequality.

##### **(a) Islamic Concept of Justice – Justice (*Adl*) as Equity (*Qist*)**

According to Islam, income inequality can never be fully addressed unless and until all citizens are treated by the law as substantively equal and justice is distributive. Using the US as the example to illustrate this point, despite the election of Barack Obama as President, the majority of blacks in America remain cognizant of the fact that his election will not improve their plight unless and until a change in the composition of the US Supreme Court takes place which will allow for a change in that country's jurisprudence. According to US jurisprudence, racial minorities are less substantively equal in the US because, contrary to the Islamic concept of justice, justice is formal and not substantive. The result is that the imposition of formal justice serves to perpetuate inequality as it is incapable of redressing it.

According to the concept of formal justice, equality is to be achieved and promoted by emphasizing neutrality through the wording of laws and regulations. Laws and regulations must be neutrally worded so that, on their face, they do not discriminate. However, no regard is to be paid to the real-world effect of those laws, that is, whether they result in discrimination thereby perpetuating inequality. Where discrimination results due to the application of a neutrally-worded law or regulation, unless it can be proven that such a law or regulation was enacted with the intent to discriminate, it will never be subjected to the level of scrutiny capable of striking it down. For example, in *Washington v. Davis*,<sup>18</sup> the imposition of a verbal skills test called "Test 21" for police officer applicants in Washington DC resulted in an inordinate number of black people failing it and thus being unable to qualify as prospective police officers. Although the imposition of Test 21 resulted in a disparate impact against blacks, due to the fact that this test was imposed neutrally, that is, upon all applicants equally regardless of their personal characteristics and without the intent to exclude blacks being proven, it was found to have satisfied the requirements of formal justice.

Had Test 21 been required to satisfy substantive justice, the mere existence of a disparate impact as to race would have triggered the requirement that Test 21 be proven to be directly correlative of competent police officer performance. Even if Test 21 could be proven to be directly correlative, substantive justice would have additionally required that proof be provided that no other better option was available. If such scrutiny had been imposed and Test 21 had failed such scrutiny, the DC Police Department would have been required to withdraw the requirement of this test. This is not to say that the imposition of substantive justice would have resulted in Test 21 being struck down. Rather, substantive justice ensures that the

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<sup>18</sup> 426 US 229 (1976).

strictest scrutiny is imposed upon laws or regulations which result in a disparate impact in order to ensure that the interests of that law are sufficiently compelling and narrowly-tailored so that, if inequality continues, it does not do so unduly. That said, whenever a law or regulation has been subjected to such strict scrutiny, rarely has such a law or regulation survived. Therefore, where a disparate impact exists, substantive justice requires that real-world results be taken into account so that inequality is not unduly perpetuated by the application of a law or regulation. As the requirements of formal justice did not require Test 21 to strict scrutiny, the fact that blacks were being excluded and disenfranchised from entering into the DC Police Department was considered, contrary to the requirements of substantive justice, largely irrelevant.

Where formal equality applies, such an outcome is predictable. Indeed, such a result was predicted in 1896 when US Supreme Court Justice Harlan attempted to convince his colleagues to grant formal equality to blacks. Justice Harlan, a racist, attempted to assure fellow racists that granting formal equality to blacks would and could do nothing to redress social and income inequality.<sup>19</sup> When formal equality was eventually adopted in the US and Justice Harlan was proven correct, US Supreme Court Justice Felix Frankfurter was inspired to declare,

“It is a wise man who said there is no greater inequality than the equal treatment of unequals.”<sup>20</sup>

The “equal treatment” referred to in the above quote is the imposition of formal equality. This quote was cited as the basis for Supreme Court of Canada’s adoption of a preference for substantive justice over formal justice, a jurisprudence which prevails in Canada today.<sup>21</sup>

The Islamic approach is to promote substantive justice. In the Holy Qur’an, the word for “justice” is *adl*. Indeed, *Al-Aadil* (the Just) is one of God’s attributes. However, as *adl* can be either formal or substantive, one must look to its synonyms in the Holy Qur’an for an indication as to what type of *adl* Islam advocates. Some of the synonyms used are *qist* (equity), *qasd* (moderation), *istiqama* (straightforwardness), *wasat* (temperance), *naseeb* (foundation), *meezaan* (balance or scale), *taqweem* (straightening) and *hissa* (rightful share). Of these, *qist*, *naseeb*, *meezaan* and *taqweem* are all substantive concepts as their focus is distributive and focused on the end-result.<sup>22</sup> Indeed, of all of these synonyms, the term *qist* occurs the

<sup>19</sup> *Plessy v. Ferguson*, 163 U.S. 537 (1896).

<sup>20</sup> *Dennis v. US*, 339 U.S. 162, 184 (1950) (Frankfurter J., dissenting).

<sup>21</sup> *Andrews v. Law Society of British Columbia*, [1989] 1 SCR 143 (“In simple terms, then, it may be said that a law which treats all identically and which provides equality of treatment between “A” and “B” might well cause inequality for “C”, depending on differences in personal characteristics and situations. To approach the ideal of full equality before and under the law -- and in human affairs an approach is all that can be expected -- the main consideration must be the impact of the law on the individual or the group concerned. Recognizing that there will always be an infinite variety of personal characteristics, capacities, entitlements and merits among those subject to a law, there must be accorded, as nearly as may be possible, an equality of benefit and protection and no more of the restrictions, penalties or burdens imposed upon one than another. In other words, the admittedly unattainable ideal should be that a law expressed to bind all should not because of irrelevant personal differences have a more burdensome or less beneficial impact on one than another.”); *R. Big M Drug Mart*, [1985] 1 SCR 295, 347 (Dickson J., dissenting)(“The equality necessary to support religious freedom does not require identical treatment of all religions. In fact, the interests of true equality may well require differentiation in treatment.”).

<sup>22</sup> While Islam encourages and promotes equitable distribution, it does not coercively or forcefully impose redistribution. On the basis of the Holy Qur’an 2:257, any form of economic coercion is prohibited. For example, the forced dispossession of the rich such as that which occurred during the Bolshevik Revolution in Russia is against Islam. As noted by Hadhrat Mirza Bashiruddin Mahmud Ahmad, whenever in human history redistribution has been forcefully imposed by dispossessing the nobility, the result has always been the breeding of contempt and resentment, exacerbating societal disharmony. Forced dispossessions and redistribution have resulted in the subsequent occurrence of civil wars or the fleeing of expatriates to other countries where they conspire to fund and promote insurgencies and rebellion back home. See Hadrat Mirza Bashiruddin Mahmud Ahmad, *Nizam-e-Nau: New World Order of Islam* (Islam International

most. The terms *adl* and *qist* alone occur in the Holy Qur'an more than fifty times and are often referred to interchangeably. For example,

"O believers, be strict in observing equity (*qistai*) and bear witness only for the sake of Allah, even if it be against your own selves or against parents or kindred. Whether the person be rich or poor, in either case, Allah is more regardful of him than you could be. Therefore, follow not your vain desires so that you may act justly (*anta'dailu*)."

 (Holy Qur'an 4:136)

"O believers, be steadfast in the cause of Allah, bearing witness in equity. Let not a people's enmity towards you incite you to act contrary to justice, be always just, that is closest to righteousness."

 (Holy Qur'an 5:9)

"And if two parties of believers fight *against each other*, make peace between them; then if *after that* one of them transgresses against the other, fight the party that transgresses until it returns to the command of Allah. Then if it returns, make peace between them with equity, and act justly. Verily, Allah loves the just."

 (Holy Qur'an 49:10)

"And let there be among you a body of men who should invite to goodness, and enjoin equity and forbid evil. And it is they who shall prosper."

 (Holy Qur'an 3:105)

"And O my people, give full measure and full weight with equity, and defraud not people of their things and commit not iniquity in the earth, causing disorder."

 (Holy Qur'an 11:86)

"Allah forbids you not, respecting those who have not fought against you on account of *your* religion, and who have not driven you forth from your homes, that you be kind to them and act equitably towards them; surely Allah loves those who are equitable."

 (Holy Qur'an 60:9)

These verses illustrate that the concepts of *adl* and *qist* are intimately related to each other. The recurrent and interchangeable use of *qist* serves to define *adl* and indicate Islam law's primary focus, namely, the pursuit of justice as equity and thus substantive justice.

According to the concept of Islamic justice, the legal and regulatory framework must be sensitive to the real-world plight of citizens and thus encourage real-world equality, and not just formality or equality in name only. As only substantive justice acknowledges and addresses actual inequality, only it can be successful in redressing it and ending its perpetuation. Until a legal and regulatory system is founded upon the notion of promoting substantive justice, in-roads cannot be made in redressing societal and income inequality and thus economic instability.

#### **(b) Prohibiting Exploitation (*Ribaa*)**

One of the defining characteristics of Islamic economics is the prohibition of *riba*, the meaning of which, literally, is "increase". The *fiqh* literature has defined *riba* as "usury", "interest" or any increase that is gained over and above a loan's principal amount. In the Holy Qur'an, while the context of the prohibition of *riba* is always made with reference to debt transactions, in the Hadith of the Holy Prophet Muhammad (sa), it is always referred to in the context of purchase and sale transactions. Therefore, as the Holy Qur'an and Hadith, when read together, have not confined the concept of *riba* to loan or deposit transactions only, at the very least, the concept of *riba* is certainly not confined to such contexts. Therefore, for purposes of this general discussion, I will focus on the *hikma* (rationale or moral intent) of the prohibition of *riba* which is to prohibit economic exploitation and the perpetuation of debt and poverty.

In the Holy Qur'an, the condemnation of *riba* is found at 30:40, 3:131 and 2:276-281,<sup>23</sup> which state as follows:

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Publications 2005). Forced redistributions can never serve the interests of achieving long-term mutual and social harmony, cooperation and consideration amongst people.

<sup>23</sup> The Jews are condemned for taking *riba* at Holy Qur'an 4:162.

And whatever you may give out in *riba* so that it may increase through other people's wealth, does not increase in the sight of Allah, but whatever you give by way of *zaka* seeking Allah's pleasure, will receive manifold increase. (Holy Qur'an 30:40)

"O believers, do not consume *riba*, doubling and redoubling, and fear God so that you may prosper." (Holy Qur'an 3:131)

"Those who devour *riba* do not rise except arises one whom Satan has smitten with insanity. That is because they say, 'Trade is like *riba*.' And yet God has made trade lawful, and *riba* unlawful. So he to whom an admonition comes from his Lord and he desists [in taking *riba*], then will that which he received in the past be his, and his case is with Allah. And those who revert to it, they are the inmates of the Fire, therein shall they abide. Allah deprives *riba* of all blessing, whereas He blesses *sadaqa* with growth. And God loves none who is ungrateful and persists in sin. Surely, those who believe and do good deeds and observe *salat* and pay *zaka* shall have their reward from their Lord, and no fear shall come to them. Believers! Fear Allah and relinquish all outstanding *riba* if you are believers. But if you do not do so, then beware of war from Allah and His Messenger, and if you repent, then you are entitled to your principal, thus you shall not wrong nor shall you be wronged. And if the debtor be in straitened circumstances, then grant him respite till a time of ease, and that you remit it as *sadaqa* shall be better for you." (2:276-81)

When the Holy Qur'an refers to the context of the prohibition of *riba*, it always does so in the context of a loan transaction to a borrower who is poor. Therefore, one can conclude that the loan in question is a subsistence loan. Also, in each scenario, either the poor debtor has defaulted in his payments or the loan has matured and he is unable to pay. Whenever the Holy Qur'an refers to *riba*, it is not contrasted with the concept of profit, but rather, is always contrasted with the concepts of *zaka* and *sadaqa*.<sup>24</sup> When the poor debtor experiences repayment difficulty, the Holy Qur'an either advises extending the loan without penalty or, even better, forgiving it as charity (*sadaqa*). Any penalty imposed upon the debtor at the time of their difficulty is referred to as *riba*. Therefore, based on a plain reading of the Holy Qur'an, at a minimum, the prohibition of *riba* serves to prohibit the imposition of any form of default penalty upon the poor. At the time of Holy Prophet (sa), such default penalties consisted of doubling the principal and then renewing the loan. In the modern context, one of the most common forms of default penalty is compounding interest.<sup>25</sup> Such default penalties can only have one outcome which is to sink the debtor deeper into debt, and in the context of a poor debtor, to exacerbate and perpetuate their poverty. Therefore, in the context of the scenario provided in the Holy Qur'an, the intent for the prohibition of *riba* is to end the exacerbation and perpetuation of a poor debtor's debt.<sup>26</sup> However, as the following discussion will illustrate, the concept of *riba* is not confined to subsistence loan scenarios.

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<sup>24</sup> This point is emphasized by Imam Razi in his *Tafsir*, Part VII.

<sup>25</sup> Compounding interest is defined as "interest upon interest". When a borrower defaults on a loan payment, the interest that would have been owed at the time the payment was due is added to the principal of the loan. As a result, thereafter, any future calculations of interest are calculated on the basis of the newly increased principal. In this manner, the borrower pays interest on the interest that they previously owed.

<sup>26</sup> This paper will not discuss what constitutes a just and reasonable compensation to a lender for the service of lending money nor will it discuss whether the prohibition of *riba* is applicable to a modern conventional banking context, where the determination of a rate of interest (or cost of borrowing) is relatively non-arbitrary with full cost of borrowing disclosure provided at the time of the entering into of the loan contract. Also, this paper will not discuss whether the prohibition applies to loans for non-humanitarian purposes, to the affluent, or for trade and commercial purposes. Any discussion regarding these would, of course, need to take into consideration the injunctions contained in the Holy Qur'an at 7:33, 10:60, 66:2 and 16:117 (pointing out the grievous sin associated with forbidding what God has made lawful) as well as the overall purpose of the prohibition of *riba* and the furtherance of this objective. However, for purposes of this paper, it is sufficient to say that the current slate of so-called Islamic banking

While there appears to be very few Hadith of the Holy Prophet (sa) which explain the meaning of the term *ribaa*, something which prompted Hadhrat Umar (ra) to lament,<sup>27</sup> what little we have provides much guidance regarding understanding the *hikma* of the prohibition. In contrast to the Holy Qur'an, the Hadith does not refer to the prohibition of *ribaa* in the context of loan transactions, but rather, does so in the context of sale transactions, thereby reinforcing the view that the prohibition of *ribaa* is not confined to default penalties levied upon subsistence loans. Although there are numerous Hadith on the subject that are all consistent with each other, the most comprehensive and oft-cited ones are as follows:

“The Prophet (sa) said: ‘Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt should be exchanged like for like, equal for equal and hand-to-hand [on the spot]. If the types of the exchanged commodities are different, then sell them as you wish, if they are exchanged on the basis of a hand-to-hand transaction.’”<sup>28</sup>

It is reported that Bilal (ra) brought *barni* [high quality dates] for the Prophet (sa). The Prophet (sa) said: ‘From where is this?’ Bilal (ra) said: ‘We had inferior quality dates so I exchanged two measures of them for one measure.’ The Prophet (sa) said: ‘This is exactly *ribaa*. This is exactly *ribaa*. Do not do this. If you wish to buy *barni*, sell the low quality dates for *dinars* (cash currency) and then buy *barni* with that.’”<sup>29</sup>

The purpose of the above Hadith is to illustrate that the purpose of the prohibition of *ribaa* is, in addition to encouraging the use of currency for transactional purposes, to prevent the exploitation of the poor. At the time of the Holy Prophet (sa), the exchange of inferior goods for higher quality goods tended to be almost exclusively carried out by the less affluent due to necessity. By virtue of being the weaker party in such transactions, the poor were always at risk of exploitation by being forced a higher countervalue, either in terms of quality or quantity, either at the time of the transaction or in the future. Given that gold, silver, wheat, barley, dates and salt were the essential items in the Arabian economy, the Holy Prophet (sa) could not tolerate the exploitation of the poor with regards to the purchase and sale of these goods. Therefore, as discussed with reference to the Holy Qur'an, the prohibition of *ribaa* originates out of a concern for the poor and ensuring that their poverty is not exploited and further exacerbated and perpetuated.

## 5. Conclusion

Although Islamic economics is a capitalistic system, it does not condone a “more is better” attitude nor does it connote wealth and prosperity with divine favour. Instead, while encouraging the enjoyment of worldly things, Islam enjoins recognizing the ownership of God in all things through trust and gratefulness, and consuming with moderation, shunning extravagance and hoarding, and honouring the share of the poor in one’s wealth through *zakat* and *sadaqa*. Further, Islamic society must be founded upon a regulatory framework which promotes substantive justice as well as the prohibits the exploitation of the poor and the perpetuation of their poverty. The purpose of the foundational principles of Islamic economics is to ameliorate income inequality and disparity. As widening income inequality and disparity have historically been the harbingers of economic downturn and instability, only once the Islamic economic principles are adopted can we begin to go down the road of establishing a stable and sustainable economy.

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products based on the *fiqh* literature offered today appear to bear little relation to the *hikma* of the prohibition of *ribaa*. For a brief discussion of these Islamic banking products, see APPENDIX A.

<sup>27</sup> Ibn Kathir, *Tafsir*, Part I.

<sup>28</sup> Muslim 10:3853.

<sup>29</sup> Muslim 10:3871.

## APPENDIX A ISLAMIC BANKING PRODUCTS

The following is a brief discussion of today's most prevalent Islamic banking products. The current slate of so-called Islamic banking products based on the *fiqh* literature appear to bear little relation to the *hikma* of the prohibition of *riba*. Indeed, the *fiqh* literature contains virtually no discussion of the *hikma* of the prohibition of *riba*. Instead, the *fiqh* literature focuses on interpreting the prohibition of *riba* to be a prohibition of any increase or profit over and above a loan's principal amount and thus provides certain alternative structures to the convention form of bank-financing, namely, *mudharaba*, *musharaka*, *murabaha* and two forms of deposit arrangements (demand and investment).

### **Profit-and-Loss Sharing Mechanisms – *Mudharaba* and *Musharaka***

The profit-and-loss sharing mechanisms are *mudharaba* and *musharaka*, neither of which are popular for usage by banks for financing on the basis that they are deemed too risk-laden and uncertain. In a *mudharaba* transaction, where the *rabb al-mal* (investor) entrusts an investment to a *mudharib* (venturer) to conduct and manage a business and to share the profits based upon a pre-agreed upon ratio is rarely utilized unless there is an extremely high degree of trust by the *rabb al-mal* in the *mudharib*, and even then, it is usually only employed for a short-term duration. Similarly, the *musharaka* (partnership) mechanism is also rarely used because, while both partners invest their respective percentages of the capital and share the profits and losses in accordance with their pre-agreed ratios, regardless of whether both partners participate in the venture's management or just one does, the high degree of trust necessary for partners to engage in this form of venture often results in it not being utilized. Interestingly, the scholarship notes the lack of trustworthiness of Pakistanis as a reason for banks' reluctance to provide funding in accordance with these profit-and-loss mechanisms in Pakistan.<sup>30</sup> When banks do invest, either as *rabb al-mal* or as a partner, they only do so by imposing highly onerous and restrictive conditions as well as regular reporting requirements in order to mitigate the risk exposure to *mudharib* or partner untrustworthiness thereby prompting scholars to question whether the underlying purpose of these mechanisms has been defeated by the imposition of such conditions and reporting requirements.

### **“Mark-Up” Financing Mechanism -- *Murabaha***

Due to the fact that the profit-and-loss sharing mechanisms, *mudharaba* and *musharaka*, are considered too risk-laden and uncertain, their use gradually declined in favour of “interest-like” or “mark-up” financing mechanisms, the most important and prominent of them being *murabaha* (deferred payment sale), which is of short-term duration. For *murabaha*, (1) A contracts with B for the purchase of a good, (2) B does not possess the good, so B purchases the good from C, and (3) B then delivers the good to A. B collects a “mark-up” from A for acting as the “middleman”. The mark-up is usually in the form of a percentage of the purchase price plus costs. Essentially, the mark-up constitutes a commission sales rate. Although this form of transaction is not referred to anywhere in the Holy Qur'an and Hadith, *fiqh* scholarship supports it on the basis that B is justified in buying and then re-selling a good at a profit, a concept that was well-recognized at the time of the Holy Prophet (sa). However, the *fiqh* scholarship notes that there is no evidence that, in Medina, buying was done on behalf of someone for a fee. Therefore, what must be kept in mind is that this form of transaction is a credit transaction because when B purchases from C, B does so having faith that A will provide reimbursement at the time of delivery. As a result, B's purchase from C is based on A's creditworthiness, and thus the mark-up is an “increase”. However, in order for this transaction to not constitute a *riba* transaction as interpreted by the *fiqh* literature, *fiqh* scholarship re-characterized it as a “sale” transaction by referring to it a “deferred payment sale”. In other words, the use of the term “deferred payment” is meant to hide the fact that this is actually a credit transaction.

The justification given by *fiqh* scholars for the Islamic legality of the mark-up is that (1) the rate was agreed upon by A and B at the time they entered into their contract and (2) the rate takes into account the time value of money (since money today is never worth the same tomorrow, due to inflation or deflation, and that the mark-up is always higher the longer the period of time between the purchase from C and the

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<sup>30</sup> See e.g., Abdullah Saeed, *Islamic Banking and Interest*, p. 71-72 (Brill 1999).

delivery to A). Ironically, this *fiqh* justification is equally applicable to a conventional form of loan where B lends the money to A at a prescribed rate of interest for A to purchase directly from C. Indeed, evidence shows that the *murabaha* transaction costs more for A than a conventional loan transaction because the additional costs of B must be borne by and recovered from A. In a *murabaha* transaction, B must not only provide A with credit but it must also correspond with and take delivery of the good from C and then store and deliver the good to A, all of which is activity that is over-and-above the simple lending of funds to facilitate A's purchase. Where B is a bank, such activities are well beyond banking expertise, and thus tend to constitute a costly reimbursement burden for A. Based on the fact that there appears to be no substantive difference between the mark-up and interest, critics of the *murabaha* form of transaction accuse the *fiqh* scholarship of relying on form over substance in order to bless a form of transaction which not only possesses the characteristics of a credit transaction but is actually more expensive and thus less advantageous than a conventional loan transaction, an outcome which these critics argue could not have been the intent of the prohibition of *riba*.

### **Deposits – Demand and Investment**

Returns on deposits have also been an area of debate. In today's Islamic banking practice, two types of deposits exist, (1) demand deposit and (2) investment deposit. The demand deposit (*wadi'a*) is derived from the notion of safekeeping or custodianship. However, according to the *fiqh* scholarship, once a depositor deposits money pursuant to a demand deposit arrangement into a bank, that deposit becomes a loan (*qardh*) to that bank. As the *fiqh* scholarship interprets any positive return on such a deposit as an increase received from a loan, the depositor is only entitled to the original amount of the deposit and no more, regardless of inflation. In addition, being a debtor, the bank possesses the absolute right to utilize its loan proceeds as it deems fit. As a result, any positive returns earned on such deposits are to the account of the bank only. If the depositor wishes to share in the positive return of the deposit, then he must make an investment deposit. An investment deposit is akin to *mudharaba*, with the depositor being the *rabb al-mal* and the bank being the *mudharib*. However, in such an arrangement, although the depositor will share in the positive returns, in the event of a loss, the bank will not be liable and the depositor must bear the entire loss without recourse. Critics of these forms of deposit state that Islamic banks are able to utilize depositor's money in a manner that not only provides an overwhelmingly inordinate benefit to the banks but is detrimental to the depositor – either the depositor does not share in the returns at all and only receives his original principal amount (thereby allowing the bank to utilize his money for free), or the depositor shares in the returns but, instead of sharing the risk, he bears 100% of the risk. According to critics, neither of these alternatives is just nor do they bear any relation to the purpose of the prohibition of *riba*.