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# An Ideal Islamic Economic System: A Gone Case? Salman Ahmed Shaikh<sup>1</sup>

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## Abstract

*Islamic finance industry mostly uses LIBOR linked financial contracts which are akin to debt financing than the more preferable participatory modes of Mudarabah and Musharakah. As per the current orthodox understanding and practice of Islamic finance, the often cited preferable modes like Mudarabah and Musharakah are incapable even in a simple model economy with them as the only mode of financing. Hence, they are rarely used. The prevalent Islamic products which are linked with LIBOR are and will predominantly be used and practiced Islamic finance may remain incapable of providing egalitarian benefits it once promised. Ironically, Islamic values like justice, equality, truth, trust, kindness, honesty and responsibility are often discussed in literature and seminars on Islamic Economics; whereas, in reality, the lack of these values in practice is the major reason why preferable participatory modes remain unusable! As discussed, the current orthodox understanding of Islamic fiscal redistribution mechanisms like Zakat and Inheritance also make them incapable of contributing towards the establishment of an egalitarian economic framework. This paper proposes an alternate approach to practiced Islamic finance and orthodox understanding of Zakat and inheritance laws and shows that the alternate approach could still be sufficient to contribute towards egalitarian objectives effectively.*

**Keywords** *Islamic Finance, Islamic Economics, Welfare Economics, Experimental Economics, Heterodox Economics, Zakat, Fiscal Redistribution*

## 1. A Look at Practiced Islamic Finance

Islamic Finance is a growing industry which is constantly evolving and has been competitive to reach and sustain its growth momentum amid even the Great Recession and beyond. Assets of the global Islamic finance industry are estimated to grow to around \$1.6 trillion by 2012 (Source: Reuters). Lately, the Vatican said that banks should look at the rules of Islamic finance

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to restore confidence amongst their clients at a time of global economic crisis. (Source: Osservatore, March 04, 2009). Some reports suggest that assets held by Islamic financial institutions may rise five-fold to more than \$5 trillion (Source: Moody's Investor Service).

But, Islamic finance industry mostly uses LIBOR linked financial contracts which are akin to debt financing than the more preferable participatory modes of Mudarabah and Musharakah.

### **1.1. Time Value of Money & Islamic Finance**

In investment for trade (which Islam allows), the investment goes through the entire process of a commercial activity that involves risk taking at each stage and any compensation on investment is strictly dependent upon the outcome of the commercial activity. The profit for the businessman strictly depends upon the actual profit realized after taking market risk including price risk. It does not depend upon time.

Time value of money is the basis of interest. Time value of money is the problem for the investor to avoid keeping his money idle and to avoid forgoing the use of money that may bring positive value to his investment. However, it does not mean that the investor can demand an arbitrary increase (or is given as the case may be) as the cost of using money without taking the market and price risk.

Assigning weightage to investment based on tenor of investment through which horizontal distribution of profit takes place in Islamic banking creates the same yield curve as in the case of term deposits of conventional banks. The situation where losses are incurred would have been very interesting, but the money is invested in contracts in which the chance of loss is remote. Also, the arrangement is such that the bank makes sure that it gets comparable returns taking LIBOR as the benchmark rate. Now a discussion on those instruments (assets of the bank) will inquire that how these instruments enable the bank to provide compensation based on tenor.

### **1.2. Analysis of Diminishing Musharakah**

In 'Diminishing Musharakah', two contracts i.e. tenancy and sale are included as two separate components of a Diminishing Musharakah contract. Both these contracts are separated by way of a unilateral undertaking in place of the actual simultaneous sale/purchase of units of the asset/property. The rent is calculated and charged on the basis of LIBOR. The rent increases when the LIBOR increases.

Upon close inquiry, one can notice that undertaking or promise makes the contract conditional. This argument is further substantiated by the fact that if the client refuses to undertake or promise to buy the asset (in units), the bank will not make contract with him. Furthermore, the promise gives the legal cover to the bank and is acceptable in a court of law.

Following table compares the conventional mortgage and 'Diminishing Musharakah'. It can be seen from the table above that there is hardly any difference between the two modes of financing with respect to the flow of funds.

<b>Features</b>	<b>Conventional Mortgage</b>	<b>Diminishing Musharakah</b>
Benchmark Rate	KIBOR	KIBOR
Basis of Rent	KIBOR	KIBOR
Nature of Installment	Interest + Principal Repayment	Rent + Sale of Units
Prepayment Penalty	Yes	Sale of Units at Higher Price
Rent + Sale contract	Dependent	Separated by unilateral promise
In subsequent years	Interest decreases	Rent payment decreases
In subsequent years	Principal repayment increases	More Units are purchased
Changes in Rent	Based on KIBOR	Based on KIBOR
Price and Market Risk	No	No
Price of Asset	Locked at initiation	Locked at Initiation
Cost to the borrower	Same in both cases	Same in both cases
Profit to the bank	Same in both cases	Same in both cases

### **1.3. Analysis of Risk Taking by Bank**

There are several types of risks. The most relevant risk is the market risk including price risk i.e. the risk that the goods will not be sold or will be sold at lower prices that may or may not cover costs. In 'Murabaha' and 'Diminishing Musharakah', price and market risk is not taken by the bank. Insurance, import duty, levies, and all other expenses are indirectly charged from the customer through transfer pricing.

Had the tenancy and sale contract were made separately, the bank would have had to bear the market risk which the bank avoids by taking a unilateral undertaking from the customer to lease or purchase an asset in Ijara/Diminishing Musharakah and Murabaha respectively.

El-Gamal (2008) criticized current Islamic banking by stating that the primary emphasis in Islamic finance is not on efficiency and fair pricing. Rather, the emphasis is on contract mechanics and certification of Islamicity by "Shariah Supervisory Boards".

### **1.4. Analysis of Murabaha**

It is referred to as “cost + profit” transaction. In this transaction, if a person needs a machine worth Rs.100,000. The bank appoints the person as an agent to buy it and before it pays the amount (Rs. 100,000) to the supplier, the bank makes sure that the customer signs an undertaking to buy the asset. This undertaking by the customer is later used to sell the asset to the customer at a profit. The bank makes sure that it gets the required profit by locking the price at the outset and avoids taking any market related risk.

Undertaking to purchase the asset once the asset is bought by the client as an agent of the bank makes the contract conditional. This undertaking is taken from the client before the bank releases funds. This argument is further substantiated by the fact that if the client refuses to undertake or promise to buy the asset, the bank will not make contract with him. Furthermore, the promise gives legal remedy to the bank and is acceptable in a court of law.

Usmani (2003) describing the less ideal nature of Murabaha with respect to contributing to the goals of socio-economic redistribution in economy wrote:

“The instruments of leasing and Murabaha are sometimes criticized on the ground that their net result is often the same as the net result of an interest-based borrowing. This criticism is justified to some extent, and that is why, the Shariah supervisory Boards are unanimous on the point that they are not ideal modes of financing and they should be used only in cases of need with full observation of the conditions prescribed by Shariah.” (p. 13)

Commodity Murabaha used by the Islamic bank’s treasury for asset liability management (basing their actions on the opinion of scholars that ‘Murabaha is allowed, even if not ideal’) took the allowance to the extreme whereby in Commodity Murabaha transactions, the subject matter is not genuinely required by both financial institutions, but each of them takes ownership literally for some minutes and execute a complex sale resulting in a profit for one and fulfillment of liquidity requirement for the other.

Similarly, use of sale and lease back transaction in house construction finance and in commercial finance is also a transaction in which Islamic bank purchases the asset without any need of its own from the same customer to whom the asset is leased subsequently. The lapse of at least one year period between sale and lease recommended by Shariah scholars is also not a sufficient justification as the Islamic bank takes undertaking from the client beforehand to lease it after one year.

With Murabaha as an alternative, profitable companies will not opt for Mudarabah/Musharakah because they will not like to share profits and else

would go for cheaper way of sourcing funds i.e. debt financing. Less profitable companies will want to go for Mudarabah/Musharakah, but bank as conservative financial institution will not take risk with these companies. The argument that Mudarabah/Musharakah financing is not possible due to lack of authentic documentation and trust level is also very weak. Islamic banks operating in developed markets (it is to be noted that the developed countries are the hub of Islamic banking) where such problems are not found have also not gone for Mudarabah/Musharakah financing. As a matter of fact, Islamic banks do not want to take market and price risk. Default, credit, political, exchange and other risks are also taken by conventional banks. If Mudarabah and Musharakah are deemed ideal alternatives by Islamic banking experts and scholars favoring it; then, they would have been better off entering into investment banking before they entered into commercial banking.

### **1.5. Analysis of Salam**

Salam is an alternative for short selling. Its allowance is confirmed from an authentic Hadith. It is a sale in which payment (in full) is at spot but delivery is deferred. But, it is to be noted that the transaction approved by Prophet Muhammad (pbuh) did not involve a financial intermediary. Ideally, we have to eliminate the need of excessive financial intermediation and look for the alternative methods, some of which have been suggested later in the paper and also in my book *'Proposal for a New Economic Framework Based on Islamic Principles'* and more research is required in this regard. In parallel Salam, the same problem of contingency in contracts persists.

### **1.6. Analysis of Mudarabah**

One of the major impediments in the use of Mudarabah on the asset side of a bank i.e. for financing is that only Rabb-ul-Maal is considered to bear all the financial losses. Therefore, if an Islamic bank enters into the Mudarabah contract as a Rabb-ul-Maal, only the Islamic bank would have to bear all the losses. Mudarib (Fund manager) bears no loss while he has the complete authority in running the affairs of the business. The Rabb-ul-maal (investor) is not allowed to interfere in the affairs of the business. When a loss occurs, the Mudarib acts like an employee of the business and when the profit occurs, he shares in the profit as if he was the only reason behind the profits. This juristic viewpoint didn't create much problem during early Islamic era when mostly the Mudarib was a poor and resource-less person in financial need with limited incentive and authority to enter in corruption and no capacity to participate in loss sharing if the loss was caused by any reason other than negligence on his part.

The principle that loss sharing should be based upon and limited to the amount of capital invested is not a condition mentioned in Quran or Hadith. Fuqaha recommended it, but it does not mean that it can not be modified, especially if doing so is necessary and will make the preferable Islamic modes of financing more applicable. When we make terms and conditions for employment contracts, for appointment of Shariah Advisors etc, any condition not in violation with Islamic principles is allowed and is used. Similarly, limiting loss sharing up to the amount of capital invested is not the only way loss sharing could take place.

Furthermore, in Musharakah, loss participation by all partners across the board is justifiable because all partners are also allowed to work. But, due to the condition in Mudarabah that working partner is the sole authority to make decisions on business, making Rabb-ul-Maal completely responsible for sharing all losses is unjustified in the first place.

It is considered that in case of loss, Mudarib loses the compensation to his efforts. But, Mudarib was not an employee. He was a joint partner, more precisely, a working partner. Taking the position that he lost the compensation to his work is inviting opportunity cost which Islamic economics does not acknowledge apparently.

In Mudarabah, the prevalent concept of loss sharing makes it different from a General partnership (all partners have unlimited liability) and even with limited partnership (some or all have limited liability). In Mudarabah, Rabb-ul Maal not only has unlimited liability, but no authority to participate in the business. Consider an Islamic economy with Mudarabah on asset and liability side and there is no other instrument used, Mudarib (usually blue chip companies) with no liability to share loss can obtain financing from banks who would be Rabb-ul-Maal in asset side use of Mudarabah. On liability side, bank will be Mudarib and the small savers and investors will be Rabb-ul-Maal. So, any loss incurred by blue chip companies is ultimately paid by small savers and investors who have all the liability to share losses without having a say in the affairs of the business!

Restricted Mudarabah and clause of willful negligence is insufficient to protect them from losses strictly due to business cycle fluctuations. This example shows that with current structure, even Mudarabah used alone in an economy is insufficient to bring about any egalitarian change let alone prove to be more destructive than interest based system.

Let us analyze trust deficit and documentation problems which are cited as reasons why Mudarabah is not being used widely. Relax these assumptions and now consider there is no trust deficit and documentation problem in the

economy. If a loss occurs due to business cycle fluctuations, no part of the loss is borne by the business that had all the authority to run the business. The loss is borne not by the bank as well because bank is Mudarib on liability side. All loss is borne by the small savers and investors. Now consider the government prohibits interest based lending and borrowing too. Will the people want to be Rabb-ul-Maal in Mudarabah with bank or the shareholder in a blue chip company which can take all the money, invest it, earn from it and if loss occurs, pass it onto the small savers! Mudarabah (with current structure) even when assumptions of trust deficit and documentation problem are relaxed and even when there is no competing conventional banking system is ineffective to say the least.

If we look at Mudarabah as it is currently understood, Mudarib is basically an employee who would get Ujrat-e-Misl in case of loss and his compensation will feature some share in profit also. He is not liable to bear any loss. Rabb-ul-Maal is basically the entrepreneur (who has the ultimate responsibility to share losses). How is it a participatory mode then? This should not be cited as a participatory mode with current structure. Secondly, it is also different from a principal agent relationship in corporate form of organization. In that, the principal hires the agent only because of his inability/incapacity, but the rules do not restrict him not to influence agent's decisions. Important decisions taken by the agent(s) have to be vetted in AGM. Mudarabah rules even do not allow that much participation. So, in my humble opinion, we first need to justify that how Mudarabah is a "just" mode of financing, let alone a participatory one and a most preferable one.

With important covenants in place, equity financing can be used and is used widely. It is interesting to study the size of debt and equity market in developing countries. For instance, in Pakistan, corporate bond market hardly exists, whereas equity financing is more prevalent and widely used. Equity financing through shares will forever deny the claims of bankers in general and Islamic bankers in particular who hide behind trust deficit and documentation problems. Why people invest in shares of companies without any guarantee over par value let alone dividend? This is an important question to answer even if some financial tycoons help promote the practiced Islamic Finance the way it is practiced for commercial reasons.

### **1.7. Securitization, Great Recession & Islamic Finance**

The proponents of Islamic finance argue that the demise of financial institutions in developed markets was due to excessive securitization and this crisis has exposed the weaknesses in the interest based financial system.



Shaikh, Salman (2010) analyzing the tendency of proponents of Islamic finance who argue that the demise of financial institutions in developed markets was due to excessive securitization wrote:

“But, securitization in Islamic finance is also possible and is used frequently in recent times. The argument that Asset backed nature of financing would ensure effective risk management is also weak as CMOs, MBS, ABS etc were instruments with mortgage loans as their underlying assets. The problem was with excessive leveraging and lax regulation and not with securitization per se. Securitization in Islamic finance as in Sukuk also suffered a setback in Dubai Crisis in 2009/10. Asset backed financing also lacks the potential to provide need based loans for education, marriage, financing to pay short term debt, salaries, other accrued expenses to 3<sup>rd</sup> parties etc.” (p. 152)

The controversy regarding Sukuk got heated up when Maulana Taqi Usmani critically commented on unscrupulous Sukuk issuance. Maulana Taqi Usmani is reported to have said that 85% of the Sukuk issued worldwide are unislamic. (Source: BBC News, December 11, 2009).

Aldrin (2010) cautioned that due to the absence of appropriate Sukuk pricing model, industry currently uses same pricing benchmark for both conventional and Sukuk Islamic bond i.e. LIBOR. Hence, high correlation between the two instruments is no surprise; rather it must be a signal for industry to make a distinctive benchmark for itself.

Andreas & et al. (2008) critically analyzing industry practices in Sukuk argued that compared to the replication efforts made, less research and efforts were made on how to innovate and develop purely Shariah based products.

## **1.8. Concluding Remarks**

The proponents of Islamic banking repeatedly try to give some logical answers to support the case of Islamic banking. These logical arguments are analyzed briefly.

It is said that a McDonald burger in west and east may taste same, but one may be permissible i.e. halal and one may be prohibited i.e. Haram if it is prepared from the meat of the chicken which was not slaughtered in the prescribed manner. It is a very weak argument. The prohibited burger is not prohibited due to the taste. It is prohibited because the prescribed manner of slaughtering is not followed to obtain the meet for the burger. The reason of prohibition is not biological (taste), it is psychological i.e. Allah has permitted to take the life of an animal, but humans must remember that it is

Allah who has permitted them to take the life of an animal for food and must utter words which signify this understanding.

It is said that pre-marital and post-marital sex may give same utility, but one is permissible and the other is not. Here again, the reason for prohibition of pre-marital sex is not biological or with regards to difference in utility, but it is social i.e. Islam treasures family system and wants to protect its sanctity at all cost. The very structure of the family system rests on limiting free sex and confining it only to marital relations else from a social point of view, humans would be no different than animals.

Proponents of current Islamic banking argue against the viewpoint that interest is prohibited solely because of its economic evils (Usmani, 2007). Explaining the verse (Al-Baqarah: 275), they argue that the verse was revealed to clarify the difference between credit sale (of the type which is used today in Islamic banking) and Riba. There is a huge difference between interest based economic activity and trade. If there had been a little difference, Allah would have given the reason for its prohibition in place of the verse in which Allah has declared the advocate of interest as the one who has become mad by the touch of the evil (Al-Baqarah:275). Rather than being derisive here, arguments against interest should have been given. But, it was not needed because the people understood what interest was and what trade was.

Respected mainstream scholars like Mufti Taqi Usmani while explaining verse 275 of Al-Baqarah stated that if this and similar injunctions do not become clear to the human mind, it should not become a reason for argument and disbelief. However, if one reads the verse 275 of Al-Baqarah, it seems that Allah is criticizing using the very argument that no sane person can equate trade with Riba. If one does, then, he is like someone who has become mad by the touch of the devil. Following is the translation of the verse under discussion.

“Those who benefit from interest shall be raised like those who have been driven to madness by the touch of the Devil; this is because they say: "Trade is like interest" while Allah has permitted trade and forbidden interest.” [Al-Baqarah:275]

If argument of interest not prohibited due to any explicit, logical and rational reason is taken; then, we ought to believe that Allah has declared an activity to be like waging War with Allah and Prophet and 70 times more heinous than committing adultery with one's mother without making it clear why interest is prohibited!

Alternatively, if the explanation of the proponents of Islamic banking for verse 275 of Al-Baqarah is taken, then, it seems very strange that if no apparent difference exists in the economic effects of the two transactions i.e. credit sale which resembles Riba and Riba itself, why would someone indulge in Riba if the same level of profit can be achieved through a credit sale which only resembles Riba. Secondly, how strange it would be to assume that Allah would punish taker of Riba so severely, while from the economic standpoint, the one who undertakes a credit sale transaction which resembles Riba would have earned the same level of profit.

Country risk, political risk, currency risk, default risk, credit risk, interest rate risk etc are taken by conventional banks as well. The relevant risk is the price risk i.e. sale price may not cover costs and the market risk i.e. goods/services may remain unsold.

Though, proponents of Islamic Banking have promised and shown commitment that in the long run, they are working towards the objective of making a system conducive to achieve equitable distribution of income. But, if in next decade or two, the practiced Islamic Banking fails to give a result different from conventional banking in a capitalist economy; then, the proponents of Islamic Banking will have little authority remaining to criticize Capitalism.

Islamic bankers and scholars must remember the behavior of 'Ihl-e-Sabbath' and Allah's verdict on that behavior. People of Aylah were prohibited from fishing on Saturdays. The fish used to come only on Saturdays since Allah was testing their obedience. But, they made a trick to catch the fish on the Sabbath. They fixed their fishing nets and ropes on Friday so that fish get into the nets on Friday and they could catch them on Sunday. They were considered disobedient by Allah on this behavior and they were doomed.

## **2. A Look at Islamic Fiscal Policy**

Supposedly, Zakat is one of the major mechanisms for redistribution of income in an Islamic economy. But, there are following complications in Zakat rules and interpretation which leads to very low Zakat collection.

1. Only agricultural production is Zakatable.
2. Gold and Silver are Zakatable, but diamonds and other precious stones are not.
3. Dual Nisab with completely different values and hence dual exemption amount.

4. Wealth in cash is subject to Zakat, but not if it is converted into a multistoried residential bungalow or when someone purchases diamonds and precious stones with it.

5. The condition of Tamleek in Zakat i.e. the condition to make some living person the owner of Zakat. Therefore, Zakah cannot be spent for general welfare of the poor. For instance, one cannot build hospitals for the free treatment of the poor, cannot establish schools for children and cannot provide their dwellings with fresh water.

Due to these and other numerous anomalies in the current orthodox understanding of Zakat, most Muslim scholars have allowed imposition of taxes.

This is despite the fact that neither the Prophet Muhammad (pbuh) nor the pious Caliphates (rta) levied any tax other than Zakat even when they were aware of the taxes imposed by neighboring non-Muslim countries on their citizens. Saleem (1992) gave an account of the narrations of the Prophet in this regard which are mentioned below:

- a) There is no [legal] share [for the society] in the wealth [of people] except Zakat.” (Ibni Maajah: Kitab-uz-Zakat).
- b) “After you have paid the Zakat of your wealth, you have paid [all] that was [legally] required of you.” (Ibni Maajah: Kitab-uz-Zakat).
- c) “No tax-imposer shall enter paradise.” (Abu-Daud: Kitab-ul-Khiraj).

Hence, Islamic fiscal instruments as they are understood in orthodox literature also seem incapable of offering any help.

Next, we look at inheritance law of Islam which is also an important vehicle in redistribution of income at the micro level. As per the orthodox understanding of inheritance law of Islam, in some cases, the sum of the shares mentioned for beneficiaries exceeds one and hence inheritance can in no way be distributed. The problem is solved by orthodox scholars by proportionately decreasing all the shares. In Islamic jurisprudence, this is called "aul" i.e. doctrine of increase and lamentably, they regard it as one of the finest accomplishments of human intellect!

### **3. Conclusion**

As per the current orthodox understanding and practice of Islamic finance, the often cited preferable modes like Mudarabah and Musharakah are incapable even in a simple model economy with them as the only mode of financing. Hence, they are not used and will not be used due to the reasons discussed above. The prevalent Islamic products which are linked with LIBOR are and will predominantly be used and practiced Islamic finance may remain incapable of providing egalitarian benefits it once promised. Ironically, Islamic values like justice, equality, truth, trust, kindness, honesty and responsibility are often discussed in literature and seminars on Islamic Economics; whereas, in reality, the lack of these values in practice is the major reason why preferable participatory modes remain unusable! As discussed, the current orthodox understanding of Islamic fiscal redistribution mechanisms like Zakat and Inheritance also make them incapable of contributing towards the establishment of an egalitarian economic framework.

#### **4. Islamic Economic System: The Way Ahead**

In developing Islamic Economics, we first need to present the thesis of Islam answering all valid arguments against it and its teachings. Then, we can present the economic teachings of Islam which will act as broad guidelines for appropriate conduct in economic pursuits. Then, given the limits and constraints at the outset, utilizing both the literature and practice of Classical Economics and Islamic Economics, we can develop and present the foundations, institutions, instruments, mechanism and delineate role of each in the new Economic framework.

In my work on Islamic Economics, I have explained it as a blend of natural features present in Capitalism i.e. right to private property, private pursuit of economic interest, use of market forces etc used along with some distinct features derived through Islamic economic teachings i.e. interest free economy, moral check on unbridled self-pursuit and provision of socio-economic justice to achieve the goals of Socialism as far as is naturally possible without denying individual freedom and profit motive.

In Islamic fiscal economics, I have explained with reasons that Zakat is the only compulsory payment to the government on one's income and wealth in an Islamic economy. Zakatable assets should include all assets above the value of nisab except the assets in personal use and means of production. Minimum Nisab Amount is the market value of 612 grams of silver only. (See Mu'atta Imam Malik, No: 578).

Production is not limited to agriculture nowadays, but the major part of it is coming from industries as well as services sector. Therefore, industrial

production could also be taxed just like agriculture. Services income could also be taxed on the same principle.

Investment in stocks should be interpreted as any other investment with some means of earning income. Stock is a means of earning dividend or capital gains. Just like means of production/income are exempt from Zakat, investment in stocks should be exempted from Wealth Zakat as investment in stocks means that the money is not kept idle. Therefore, any income arising from investment in stocks i.e. capital gains or dividend must be subject to *Ushr*. Similarly, this argument could be extended to introduce *Ushr* on income from mutual funds, investment in other financial instruments etc. Likewise, if land/building/house is leased, the land/building/house becomes the means of earning rent. Hence, *Ushr* could also be introduced on rental income on houses, assets, buildings etc. Through an empirical study, I concluded that Zakat in this way can relieve the government of Pakistan from deficits.

In Islamic corporate finance, I suggested an alternate approach to corporate finance in an interest free economy by looking beyond practiced Islamic finance and suggested alternatives for corporate finance in sourcing funds i.e. i) Ijara with embedded options, ii) limited liability partnership, iii) equity modes like Musharakah and Mudarabah iv) income bonds and v) convertible income bonds. Then, I suggested alternatives for corporate finance in using funds (investments) i.e. i) Islamic income funds, ii) Islamic REITs, iii) GDP growth rate linked sovereign bonds, iv) income bonds v) convertible income bonds, vi) foreign currency reserves, vii) making strategic expansion, and viii) equity investments in other companies. Ijara with embedded option can solve the paradox of unilateral undertaking and convert the sale of put option from the perspective of client into a call option. In Mudarabah, following two covenants can be introduced.

a) Mudarib can be asked to contribute some capital. The contract will still remain different from Musharakah as only the Mudarib is the working partner.

b) Mudarib can be asked to share in loss to some extent.

These two covenants will minimize the problem of adverse selection, moral hazard and agency problem.

In methods of valuation in Islamic Financial Management, I suggested an alternate means of pricing capital in interest free economy and use of appropriate discount rate i.e. Nominal GDP growth rate in public finance and

corporate finance in CAPM, dividend discount model, project valuation, calculating NPV, valuing income bonds and stocks.

I also discussed in my book '*Proposal for a New Economic Framework Based on Islamic Principles*' that how savings would feature despite discontinuation of interest, how inflation will be checked with central banks not having at their disposal the conventional OMO, how liquidity will be managed in banking sector when a central bank wants to inject liquidity or mop up funds. How and to what extent the institution of Zakat would enable the government to meet its fiscal targets and does not crowd out private sector with public borrowing and how the balance of payments and exchange rate stability can be managed in an interest free economy.

## **Final Remarks**

Therefore, all is not lost. But, there is a need to realize weaknesses, only then can we look for solutions and in search for solutions, we need to be critical, objective, impersonal, unbiased and open to hear and receive all possible solutions and then accepting and rejecting any of them on the basis of authentic Islamic sources i.e. Quran, way of Prophet Muhammad (pbuh) and Sahih Ahadith rather than on the basis of factional affiliations. Only then, can we hope to progress towards the goal of an ideal Islamic Economic system.

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