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حضرت امام شافعی رحمۃ اللہ علیہ فرمایا کرتے کہ: امام مالک اور سفیان بن عیینہ نہ ہوتے تو حجاز سے علم رخصت ہو جاتا

countries do not have the will and the resources needed for this purpose. The primary reason is the conflict that exists between its goals and its strategy. The goals are humanitarian, originating from its religious past, while the strategy is social-Darwinist, based on the concept of survival of the fittest. It relies primarily on the rate of interest for allocating financial resources. This gives an edge to the rich and leads to not only concentration of wealth but also a rise in conspicuous and wasteful consumption. This hurts the realization of goals. It also contributes substantially to the prevailing instability in the international financial markets. Mills and Presley are, therefore, right in concluding that:

> "There are sufficient grounds to wish that, in hindsight, the prohibition of usury had not been undermined in Europe in the sixteenth century. More practical wisdom was embodied in the moral stand against usury than was then realized".[41]

فَضْلُ الْعَالِمِ عَلَى الْعَابِدِ
كَفَضْلِ الْقَمَرِ عَلَى سَائِرِ الْكَوَاكِبِ

(سنن ابو داود و ترمذی)

ایک عالم کو ایک عابد پر ایسی فضیلت حاصل ہے
جیسی کہ چاند کو دوسرے تمام ستاروں پر (حدث شریف)

(Qari Faizur-Rehman. Durban)

[41] Mills and Presley, 1999, p.120.

☆ اترکوا قولی بخبر الرسول ﷺ ☆ حدیث شریف کے مقابل میرے قول کو چھوڑ دو (ابو حنیفہ) ☆

was $1,490 billion in April 1998[36], which was 49 times the daily volume of world merchandise trade.[37] This indicates that a substantial volume of foreign exchange transactions is for speculative purposes. According to Andrew Crockett, General Manager of the Bank for International Settlement (BIS), "Our economies have thus become increasingly vulnerable to a possible breakdown in the payments system."[38]

If it is not desirable to rely largely on short-term credit, then the more desirable thing to do would be to rely on long-term borrowing and equity. Of these two, equity financing is preferable because it would introduce greater health in the economy through a more careful scrutiny of the projects financed.[39] A number of world-renowned scholars like Henry Simons, Hyman Minsky, Charles Kindleberger, Joan Robinson, G.L. Bach, and Kenneth Rogoff have hence concluded that an economy where there is greater reliance on equity would tend to be more stable than a debt-based economy.[40]

CONCLUSION

Thus it may be seen that greater reliance on equity financing has to be an indispensable part of the strategy of any system which wishes to actualize the humanitarian goals of need fulfillment, full employment, equitable distribution of income and wealth, and economic stability. The reason why capitalism has not been able to realize these goals effectively is not because its goals are not humanitarian or the people in capitalist

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36 See Table 1 of the BIS *Press Release* of 19 October 1998 which gives the preliminary results of the foreign exchange survey for April 1998. Such a survey is conducted by the BIS every three years.

37 World merchandise trade (imports plus exports) amounted to $908.7 billion in April 1998 (IMF, *International Financial Statistics*, November 1998). The average value of the daily world merchandise trade in April 1998 was thus only $ 30.3 billion.

38 BIS *Press Release*, 22 June 1994, p.3.

39 See IMF, *World Economic Outlook*, May 1998, p.82.

40 Simons, 1948, p.320; Minsky, 1975; see also the summary of Minsky's argument cited by Joan Robinson, December 1977, p.1331; Kindleberger, 1978, p.16; Bach, 1977, p.182; and Rogoff, fall 1999, pp.211-46.

The 1997 East Asia crisis has clearly demonstrated this. The Eastern tigers had healthy fiscal polices which could be the envy of a number of developing countries. However, the large inflow of short-term foreign funds led to rapid growth in bank credit to the private sector. This created speculative heat in the stock and property markets. It was the old mistake of lending on collateral without evaluating the underlying risks. As soon as there was a shock, there was a rapid outflow of funds, which had come primarily, on a short-term basis. This led to a precipitous fall in asset prices and exchange rates, making the borrowers unable to repay to the local banks, which could not in turn repay their short-term loans from foreign banks. There was thus a banking crisis. The IMF had to come to the help of these countries by arranging a huge amount of loans. What this ended up doing was to enable the foreign banks to get back their loans and go scot-free. The burden of the debt consequently shifted to the governments and, ultimately, to the taxpayers of these countries.

The 1998 collapse of the hedge fund, LTCM (Long-term Capital Management), was also due to highly-leveraged short-term lending. On the strength of their own equity, the hedge funds are able to borrow enormous amounts which they use to speculate in the international commodity, stock and foreign exchange markets, and thus end up destabilizing financial markets around the world. The leverage of LTCM was 25:1 before the crisis, but rose to 50:1, and ultimately to 167:1, after the crisis.[35] If the Federal Reserve had not come to its rescue, the whole world economy could have been driven to the precipice of a serious financial crisis.

The heavy reliance on short-term borrowing has injected a substantial degree of instability even in the international foreign exchange markets. Daily turnover in the international foreign exchange markets

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35 IMF, *World Economic Outlook*, December 1998, p.55. Leverage indicates the extent of borrowing on the basis of equity. A leverage of 25:1 means a loan of $25 on the strength of a capital of $1. When the leverage is high, it is difficult for borrowers to repay their loans when asset prices fall.

from such financing. The experience of the International Fund for Agricultural Development (IFAD) is that credit provided to the most enterprising of the poor is quickly repaid by them from their higher earnings.[33] Other small-loan programmes have yielded similar results in several countries. Nevertheless, it may be desirable to arrange insurance of small loans to provide protection to financiers against fraud and mismanagement.

Economic Stability

Economic activity has fluctuated throughout history for a number of reasons, some of which, like the natural phenomena, are difficult to remove. However, economic instability seems to have become exacerbated over the last three decades as a result of turbulence in the financial markets. One of the important reasons for this, according to Milton Friedman, a Nobel laureate, is the erratic behaviour of interest rates.[34] The high degree of interest rate volatility injects great uncertainty into the investment market and makes it difficult for entrepreneurs to take long-term investment decisions with confidence. This drives borrowers and lenders alike into the shorter end of the financial market. The result is a steep rise in highly leveraged short-term debt, which plays an important role in destabilizing financial markets.

One may wish to pause here to ask why a rise in short-term debt should accentuate instability. This is because short-term debt is easily reversible as far as the lenders are concerned. Its repayment is, however, difficult for the borrowers if the amount is locked up in medium- and long-term investments with a long gestation period. While there is nothing basically wrong in a reasonable amount of short-term debt, which Islam allows on the basis of its sales-based modes of financing for real goods and services, an excess of it tends to get diverted to speculation in the foreign exchange, commodity and stock markets.

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33 *The Economist,* 16 February 1985, p.15.

34 Friendman, 1982, p.4.

Equitable Distribution

The inequitable allocation of financial resources in the conventional interest-based financial system is now widely recognized. According to Arne Bigsten, "the distribution of capital is even more unequal than that of land" and "the banking system tends to reinforce the unequal distribution of capital."[30] The reason is, as already indicated, interest-based financial intermediation tends to rely heavily on collateral and to give inadequate consideration to the strength of the project or the ultimate use of financing. Hence, while deposits come from a cross-section of the society, their benefit goes largely to the rich. As Mishan has rightly pointed out: "Given that differences in wealth are substantial, it would be irrational for the lender to be willing to lend much to the impecunious as to the richer members of society, or to lend the same amounts on the same terms to each".[31] The Morgan Guarantee Trust Company, one of the largest banks in the U.S., has admitted that the banking system has failed to "finance either maturing smaller companies or venture capitalists," and "though awash with funds, is not encouraged to deliver competitively priced funding to any but the largest, most cash-rich companies."[32]

In contrast with this, risk-reward sharing could be more conducive to the realization of equity. It would tend to compel the financier to give due consideration to the strength of the project, thus making it possible for competent entrepreneurs from even the poor and the middle-classes to be at least considered for financing if they have worthwhile projects, adequate managerial ability, and a reputation for honesty and integrity. This may enable society to harness the pool of entrepreneurial ability from even the poor and middle classes. The rich contribution that such entrepreneurs can make to output, employment and need fulfillment could thus be tapped.

There is no reason to be unduly apprehensive about loan losses

30 Bigsten, 1987, p.156.

31 Mishan, 1971, p.205.

32 Morgan Guarantee Trust Company of New York, 1987, p.7.

of real interest rates. This has led to lower rates of rise in investment, which have joined hands with structural rigidities and some other socio-economic factors to reduce the rates of growth in output and employment.

Unemployment has hence become one of the most intractable problems of most countries, including those in the rich industrial world. Unemployment stood at 9.2 percent in the European Union in 1999, more than three times its level of 2.9 percent in 1971-73[28] It may not be expected to fall significantly below this level in the near future because the real rate of growth in these countries has been consistently lower than what is necessary to reduce unemployment significantly. Even more worrying is the higher than average rate of youth unemployment because it hurts their pride, dampens their faith in the future, increases their hostility towards society, and damages their personal capacities and potential contribution.[29]

A decline in speculation and wasteful spending along with a rise in saving and productive investment could be very helpful. But this may not be possible when the value system encourages both the public and the private sectors to live beyond their means and the interest-based financial intermediation makes this possible by making credit easily available without due regard to its end use. If, however, banks are required to share in the risks and rewards of financing and credit is made available primarily for real goods and services, which the Islamic system tries to ensure, the banks will be more careful in lending and credit expansion will be in step with the growth of the economy. Unproductive and speculative spending may consequently decline and more resources may become available for productive investment and development. This may lead to higher growth, a rise in employment opportunities, and a gradual decline in unemployment.

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[28] OECD, *Economic* Outlook, December 1991, Table 2, p.7; and June 2000, Table 22, p.266.

[29] A question may be raised here about the current low rate of unemployment in the U.S. in spite of a substantial decline in household saving. There are a number of reasons for this. One of the most important of these is the large inflow of foreign funds which "has helped to fund a pronounced increase in the rate of growth of the nation's capital stock"(Peach and Steindel, September 2000, p.1). Once there is a reversal of, or even a decline in, this inflow, it may be difficult to sustain the high rate of growth in output and employment. In addition the stock market may also experience a steep decline.

حضرت امام شافعی رحمۃ اللہ علیہ فرمایا کرتے کہ: امام مالک اور سفیان بن عیینہ نہ ہوتے تو حجاز سے علم رخصت ہو جاتا

Need Fulfillment

Financial intermediation on the basis of interest tends to allocate financial resources among borrowers primarily on the basis of their having acceptable collateral to guarantee the repayment of principal and sufficient cash flow to service the debt. End-use of financial resources does not constitute the main criterion. Even though collateral and cash flow are both indispensable for ensuring repayment of loans, giving them undue weight leads to a relative disregard of the purpose for which borrowing takes place. Hence, financial resources go mainly to the rich, who have the collateral as well as the cash flow, and to governments who, it is assumed, will not go bankrupt. However, the rich borrow not only for productive investment but also for conspicuous consumption and speculation, while the governments borrow not only for development and public well-being, but also for chauvinistic defence buildup and white elephant projects. This does not only accentuate macroeconomic and external imbalances, but also squeezes the resources available for need fulfillment and development. This explains why even the richest countries in the world like the United States have been unable to fulfil the essential needs of all their people in spite of their desire to do so and the abundant resources at their disposal.

Full Employment

The living beyond means which the interest-based financial intermediation has the tendency to promote through the easy availability of credit, has led to a decline in savings in almost all countries around the world. Gross domestic saving as a percent of GDP has registered a worldwide decline over the last quarter century form 26.2 percent in 1971 to 22.3 percent in 1998. The decline in industrial countries has been from 23.6 percent to 21.6 percent. That in developing countries, which need higher savings to accelerate development without a significant rise in inflation and debt-servicing burden, has been even steeper from 34.2 percent to 26.0 percent over the same period.[27] There are a number of reasons for this. One of these is the rise in consumption by both the public and the private sectors. This saving shortfall has been responsible for persistently high levels

[27] Figures have been derived from the Table on "Consumption as percent of GDP" in IMF, 2000 Yearbook, pp.177-79.

abolished the interest-based nature of the financier-entrepreneur relationship and reorganized it on the basis of profit-and-loss-sharing. This enabled the financier to have a just share and the entrepreneur did not get crushed under adverse conditions, one of which could be the caravan being waylaid on the way.

This shows that, although the extension of meaningful help to the poor carries a high priority in the Islamic value system, it was not the primary reason for the prohibition of interest. The primary reason was the realization of overall socio-economic justice, which is declared by the Qur'ân to be the main mission of all God's messengers (57:25).

Interest and the Realization of Humanitarian Goals

Justice, however, needs to be understood in a much wider context. Confining it merely to trade may not be able to take us far enough. Justice demands that the resources provided by God to mankind as a trust must be utilized in such a manner that the universally-cherished humanitarian goals of general need fulfillment, full employment, equitable distribution of income and wealth, and economic stability are optimally realized. It is the contention of this paper that these humanitarian goals can be realized more effectively if there is also a humanitarian strategy. An important, though not the only, element of such a strategy is the abolition of interest. The following discussion tries to show briefly how the interest-based financial system frustrates the optimal realization of these goals and how its reorganization in a way that increases the reliance on equity and reduces that on debt can help in their more effective realization.[26]

The subject has been discussed in greater detail by the author in Chapra, 1985, pp.19-29 and 107-145; 1992, pp. 327-34; and 2000 a and b.

حضرت امام شافعی رحمۃ اللہ علیہ کا قول ہے کہ: تمام لوگ فقہ میں امام ابو حنیفہ (رحمۃ اللہ تعالیٰ علیہ) کے پروردہ ہیں

Borrowing: Was it by the Poor or the Rich?

Those who are against the prohibition assume that interest was prohibited mainly because of the injustice it inflicted on the poor, who were charged exorbitant rates of interest for loans borrowed by them to satisfy some urgent need. This, they argue, led to exploitation and further impoverishment of the poor. They, therefore, conclude that the prohibition of interest is no longer valid because banks in modern times do not resort to such exploitation.

The assumption on which this conclusion is based does not, however, reflect the historical realities. During the Prophet's days, peace and blessings of God be on him, borrowing was not undertaken by the poor. This is because by the end of the Prophet's life, when the prohibition of interest became strictly enforced, the needs of the poor were taken care of either by the rich or the *bayt al-mal* (the Public Treasury). Therefore, the poor did not have to borrow to fulfil their needs.

This leads to the question of who borrowed and why? Borrowing was resorted to primarily by tribes and rich traders who operated as large informal partnership companies to conduct large-scale trade. This was necessitated by the prevailing circumstances. The difficult terrain, the harsh climate, and the slow means of communication made the task of trade caravans difficult and time-consuming. It was not possible for them to undertake several business trips to the East and the West during a given year. Only a few trips could be undertaken. Hence, it was necessary for the caravans to muster a large volume of financial resources to purchase all the exportable products of their society, sell them abroad, and use the proceeds to bring back the entire import needs of their society.

Before Islam such resources were mobilized on the basis of interest. This was not acceptable to Islam because it led to injustice. If there was a loss, it was the entrepreneur or the trader who had to bear the entire loss in spite of all the trouble he took. The financier, who did nothing more than providing finance, got a predetermined positive rate of return. Islam, therefore, tried to remove the injustice resulting from this. It

☆ امام اعظم ابو حنیفہ رحمۃ اللہ علیہ کا سنِ ولادت ۸۰ ہجری اور سنِ وفات ۱۵۰ ہجری ہے ☆

PROHIBITION OF INTEREST: DOES IT MAKE SENSE?

The previous paper argued that the Qur'ân has prohibited interest strictly and has declared those who take it to be at war with God and His Prophet (2:279). The Prophet, peace and blessings of God be on him, also condemned interest and equated the indulgence in it with committing adultery thirty-six times or incest with one's own mother.[20] No distinction has been made between usury and interest, and even a small gift is not allowed as a condition for a loan.[21]

However, it is not Islam alone which has prohibited interest. Other major religions like Judaism, Christianity and Hinduism, whose followers constitute two thirds of the world's population, have also done the same. The Bible disapproved of interest severely and did not recognize any distinction between usury and interest.[22] Those who took interest were branded as wicked.[23] and could not, according to the Third Lateran Council (1179), be admitted to communion or receive Christian burial.[24] The *Talmud* compared the money-lender to a murderer and the *Mishnah* disqualified him from giving evidence in a court of law.[25] This raises the question of why there is such a harsh verdict against interest in all these religions. Is there any sound rationale behind it?

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20 Reported from Abû Hurayrah in the *Bâb al-Ribâ* of *Kitâb al-Buyû'* by *Mishkât al-Masâbîh* on the authority of Ahmad and al-Dâraqutnî.

21 Reported from Anas ibn Mâlik by *ibid* on the authority of *al-Bukhârî's Târîkh* and Ibn Taymiyya's *al-Muntaqâ*

22 For the Babylonian, Jewish and Christian views on interest, see, Johns, et.al. in Hastings, Vol.12, pp. 548-58; and Noonan, 1957, p.20. For the Hindu view, see Bokare, 1993, p.168.

23 See the Bibie – Ezekiel, 18:8, 13, 7; 22:12. See also Exodus, 22: 25-27; Leviticus, 25:36-38; Deuteronomy, 23:19; and Luke, 6:35.

24 Johns, *et.al*, p.551.

25 *Ibid*, p.558.