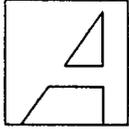

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Euro-Arab Perspective Seminar
Amman 23&24 October 1993



Konrad
-Adenauer-
Stiftung

مؤتمر
اخلاقيات الاقتصاد : وجهات نظر عربية - اوروبية
عمان : ٢٣ و ٢٤ تشرين اول ١٩٩٣

Symposium
"Ethics In Economy: Euro-Arab Perspectives"
Amman, 23 - 24. Oct. 1993



منتدى الفكر العربي
عمان
ARAB THOUGHT FORUM
AMMAN

ATF/1/132/(1)

27.9.1993

"Ethics In Economy: Euro - Arab Perspective "Seminar
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Ethics and Economics: An Islamic Perspective

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Writing about the ethical aspects and religious values in the economics of Islam is no easy task. At the outset, any religion, is in fact, a framework of values and moral codes, any aspect of which is inherently ethical in nature. Furthermore, Islam, unlike any other religion, is not confined to matters of faith and the hereafter. Rather It is a system of life that teaches Muslims all aspects of living from the right side to sleep on and the way one should walk to matters of government and economics. This, by no means imply that matters of belief are not important. On the contrary, the basic part of Islam is actually the belief in the oneness of Allah and in his Messengers. From this spring all moral teachings.

Before I begin to submit some ethical aspects in the economics of Islam, it would be useful to begin with a primer about methodology

It will be of little use to speak of general human ethics, even if they find their origins in religion. Therefore, justice, equitable distribution of income and common good can't be claimed to be the specialty of any one religion. Rather they are human values. No society, no individual, no religion, no state or legal system will depart from or take exception to these aspirations, this is too obvious. It will be of tremendous use if we engage in a comparative approach concerning ourselves with the *means* to reach these cherished ends. Rather than being lost in trying to state the obvious, it is better to try to explore the novel. We all

want justice. However, religion can play a role in showing us what is just and how to reach justice .

Furthermore, when speaking about religious ethics in the field of economics, it is important to distinguish between two possible roles of religion in society : being a source of general instructions and guidance concerning individual behavior or government conduct that may help rationalize the performance of the latter or enhance the welfare of the former. These may be preached in a very persuasive way but they are followed only if the individual or the government authority so decides to follow them. The second is doctrinal or dogmatic direction which become orders and effective constraints on the individual and the state to such a degree that they have to be followed if the individual or the society wants to be a "*believer*". I submit that we should be more concerned with the second category because it is only here that the uniqueness and originality of religious values are revealed. The first category, I think, will always remain "*common sense*" indirectly related to religion. I might add that most of the ethics of Islam we are dealing with here are of the second type.

Moreover, I believe the uniqueness of every religious ethical system, and its real characteristics can be uncovered when we are faced with a situation of conflict between social objectives. How this conflict is resolved speaks a lot about the ethical system in society. Equitable distribution of income , for example is the objective of every society. Growth and development is also an objective of every society. In a lot of times these two objectives will be in conflict. Can religion and religion based ethics provide a resolution ? This is the kind of questions that will enhance our understanding of the subject and render this exercise a

success. Without hesitation I can say Islam puts justice before growth.

It is clear, therefore, that we are speaking about "*Setting Priorities*". This is the most difficult question facing any society. Can the ethical system provide a criterion? I claim that Islamic *Sharia* is rich in this regard. It contains a "*manifesto*" for this particular purpose.

In the following pages we will confine ourselves, never the less, to the moral aspects of the economics of Islam. In particular, those aspects that do with money and banking & taxes and government finance.

I. The Idea of Vicegerency:

The foundation of the economics of Islam is that man owns money and wealth in regency. He is only a vicegerent, since the real owner is Allah. This basic idea introduces the justification for all the moral and ethical guidance and directives by which one has to be abided in, the formation, utilization and disposing of his wealth. If one is merely an agent, clearly he is to concede to the plans of the ultimate owner, basic among which is justice and equitable distribution. In Islam, however, we do not say that *Sharia* is just, rather say that *Shaira* itself the ultimate justice. This means that we need not elaborate and review legal codes derived form *Shaira* to make sure they are just we only make sure they are actually derived form *Shaira*

- a) Owner of any type of wealth is to pay the annual obligation of Zakah.

Zakah is not a duty on the wealthy but on the wealth itself. Therefore,, the institution of Zakah does not approach society as " rich and poor " nor as a " class-structured" group of people. It is due even on small amounts of wealth. Therefore, the poor will pay Zakah, albeit small, and will receive a lot more as they are in need. Members of the society will, then, feel they are all participating in a system of macro benevolence and social welfare, rather than having one class dependent on the other. Furthermore, Islam treats poverty as a temporary condition. Therefore, the dignity and basic rights of the poor must be preserved. Zakah is an obligation that is part of the basic faith of every muslim and the needy need not beg to get it. Further more, No one has the right to decide on behalf of the poor the ways of utilization of Zakah⁽¹⁾. No public projects, where rich and poor can make use of are to be financed by Zakah, not even mosques. Zakah is not to be transferred from one locality to another because it is the right of the immediate poor, where equitable distribution have to be carried out. While Zakah is imposed only on the type of wealth that has the potential to grow, it is calculated on the basis of total wealth and not on net-income. This means that Zakah is addressing the original source of inequitable income distribution, that is inequitable wealth distribution.

b) One is to utilize his wealth modestly, with great concern for the welfare of others and high regard for the maintenance of the sources of wealth⁽²⁾ . While charity and almsgiving is encouraged, wealth by itself is not denounced in Islam, poverty is not praised. On the contrary, tenentes of Sharia put no limit on wealth (given that obligation and means of accumulation are acceptable), it imposes no ceiling on profits or prices

(given that monopoly and abuse are non-existent).

c) Because one is only an agent, he has the freedom to use and avail himself of his wealth, but only within the duration of his life. Upon death, the ultimate owner's (Allah) prescribed disposition must take effect. One has no right to relinquish his bequest to whom ever he desires. Rather, a very elaborate pre-set formula determines such distribution⁽³⁾, with one main objective which is to enhance equitable distribution.

II. Money:

Money, in any society has two aspects, individualistic and communal. It is a store of value representing personal wealth, but it is also a social institution serving as a medium of exchange and a measure of value. For the system to be stable, just and a means for more welfare in society, the social and communal aspects of money ought not to be undermined by selfish behavior of individuals. If we are to avoid "big government" and extensive legal restrictions on personal freedoms, it has to be part of the norms and moral order of individuals to uphold these important aspects as part of their ethics & religion.

(a) The Koran condemned those who stock and lock away gold and silver, (and for our modern times paper money) because this means withdrawing money out of circulation causing the economy to shrink⁽⁴⁾. In the absence of a central bank, surely this will have quite a prolific and significant effects on growth and stability.

(b) While barter may serve as a system of exchange, compared to money, barter can't support a viable economic system that is capable of sustaining growth and development. Prophet Mohamad (PBUH), ordered his companions to sell their goods and use the proceeds to buy what they need rather than barter⁽⁵⁾. Not only that more monetization of society will mean the enlargement of the market, it will also lead to more equitable exchange because the existence of standard measure of value will enhance such direction.

(c) Some individuals may find it profitable to scrap every coin that passes through their hands. Little as the outcome may be, in a while they will amass a sizeable quantity of gold. Being so concerned with the well being of the whole society, this is, in Islam a sin that is punishable even in the hereafter. While this may seem irrelevant in the age of credit cards and electronic money, it surely does have important ethical implications that are quite pertinent to modern times.

(d) The most important ethical aspect of money in Islam is that which does with usurious transaction:

(i) Usury, or Riba as it is called in Arabic, is prohibited. Certainly Riba is denounced and condemned in all religions. What is unique about the Islamic view point is that definition of Riba is so distinctly lucid and crystal clear. It is so precise that it loses no relevance or potency as monetary systems evolve and change over time. Usury is simply an increase in a loan contract and the

introduction of fiat money...
not have to be a monetary one. Rather, any fungible can be subject to borrowing-lending relationship. Furthermore, *Sharia* does not distinguish a large increase from a modest one, any increase is considered Riba.

Sharia does not stop at only pointing at what it is to be avoided as Riba. It goes many steps further prohibiting all types of transactions that lead, indirectly, to the same outcome. This further clarifies the essence of Usury in *Sharia*. For example, the rules of exchange of money are different in *Sharia* from those of other goods and services. One can use silver to buy gold (and vice versa) but exchange has to be spontaneous and delay of either is not allowed. This is also the case for example for Dollar and Sterling Pound and any other currency for that matter. Reason is simply that permitting a postponement will undermine the prohibition of Riba, because the parties can conclude the deal at any price including one that carries an interest - like addition. Another, is the prohibition of the sale of debt. As it is well known, debt swaps & securitization of debt obligations are in vogue now a days. While they introduce liquidity to the financial market, they accumulate in such a way that inflates the financial sector of the economy with no comparable real transactions. From *Sharia* point of view such sale is simply a means to circumvent of the prohibition of the Riba, it is therefore not permitted.

III. Banking:

Human societies consists, always, of two categories of people. Those who own resources in excess of their immediate needs, and those who need more than they posses now. They realized, very early in the history of mankind, that an arrangement to transfer resources form the first to the second will make society more efficient and enhance the welfare of every one. With the invention of money, this fact became more obvious. At certain points temples and the clergy played an important role in the management of such activity. With the advent of the age of specialization and division of labor, this exercise was institutionalized into an organization for financial intermediation i.e banking establishment. Being a private enterprize this firm had to make money, therefore it adopted the form of borrower-lender relationship, where it borrows money from the first category (and pays interest) and lends to the latter (receives interest).

Islamic civilization reached its highest point in the late middle age. Clearly commerce and over land trade were the highlight of that civilization. Yet the model of commercial banking did not appear in Muslim societies although it was known in some parts of Europe since the 13th century. Reason is two fold:

(a) on the one hand, the prohibition of Riba meant that no borrower-lender relationship can be used as an income generating activity, which meant the European model of banking is inconceivable in an Islamic society.

(b) Conventional banking superior aspect is the fact that lender-borrower relationship reduces moral hazard⁽⁷⁾, because it mitigates agency problems

by separating the reward of the financier & repayment of his principal from the actual performance of the investor & his moral leaning. Partnership, on the other hands has an incentive problem which makes it very costly since each partner need to collect information about performance & behavior of the other side and may need to inspect or confiscate.

Moral hazard becomes a problem in contractual relationship only in a society where individuals attache little value to integrity, therefore, assuming that, fundamentally, human being are not honest. That the rule model is not the virtuous and pious but rather the bad and ugly. Islamic theory of contractual relationship is jut the opposite. Almost all contracts are based on the assumption that people are good and honest and always honoring their commitments and never cheating their fellow man. This may not always be a facsimile of the real life. But it has an important "educational " effect compelling individuals to strive to the rule-model. If you keep telling (and treating) people that they are not honest, not surprisingly, they will soon be⁽⁸⁾ .

(c) on the other hand, Muslims did have different arrangements procuring the same objective i.e financial intermediation based on the tenentes of Islamic Sharia and this is where the ethical and moral aspects are most visible.

One can, generally, say that money in the Islamic Economic system can move from one individual to another for the purpose of charity and altruistic

purposes, or for profit and gain in trade. What is interesting here is that borrowing and lending relationships can only be allowed as part of the first category. Investment and profit generating activities can only be financed via partnership and profit-loss sharing arrangements. *Sharia* provides many forms of contractual relationships that meet the standard requirements of the market. They cover cases where one party provides finance only and the other provides management and labor, or where many partners participate in capital etc. for temporary one deal or long-term arrangement. *Sharia* presents a very refined orders and elaborate system of profit and loss sharing, rules of establishment, work ethics, management and termination of such contracts.

This resulted in an important attribute of the economy in Muslim societies that there is no dichotomy between real & financial activities, no two-sector economy but only one. Important consequences and ethical characteristic grew from this feature:

- (a) Most important is a more equitable income distribution because economic activities are not financed by "borrowing" capital, but by participation of owners of capital in profit & loss.

In capitalist economic system, providers of money receive a fixed return in the form of interest. If the economy is prospering and high rates of profits are being made by investors, owners of capital will not share in the fortunes of this investment. Income distribution will be biased against owners of capital. In case of depression, when lower rates of profits are being made providers of capital will get

their fixed return, albeit such return may wipe out all the income of investors, hence an inequitable income distribution.

No such thing will take place if profits & losses are shared by all participants in investment.

- (b) Not only that more equitable distribution will take place in the short run, a more stable economy will be the result in the long run. Because loss is being shared by providers of finance and not of entrepreneurs, the real sector will be able to resist recession and lower employment rates and get out of them quickly. This is because a lower rate of profit will not wipe out all the income of the enterprise nor discourage new entrepreneurs from entering the market. On the other hand, high rates of profit not mean inflation because a larger portion of which (and not only a fixed rate) will be channeled to providers of finance (savers) away from investment and into consumption.

- (c) May be the most important of the inequitable distribution which results from conventional banking is the fact that banks can only lend to the rich because they always ask for collateral and guarantees. Even if one is highly qualified, chances are that he will not get financed by banks unless he is wealthy enough to satisfy their requirements. This clearly means that credit is being circulated within a narrow group in the society perpetuating the inequitable distribution and reinforcing it. Because it is based on

profit and loss sharing and not lending, banks will be more interested in those who can generate profits, because members of the middle and lower classes of society will not be neglected or shunned just because they can't provide collateral, because no body is required to do that in a participating system.

IV. Taxation:

It would be very difficult to find a support for any tax system in the tenants of Islamic *Sharia*. In fact to the majority of Islamic scholars, taxes of any kind are not permissible in Islam. Prophet Mohamad (PBUH) and the Khalifs after him never imposed any taxes. On the contrary, the ruler who taxes his constituents is considered so sinful he has no hope of Allah's mercy in the hereafter. The ideal Islamic society is a co-operative one where most activities are done in mutual assistance and participation of individuals without government coercion. In Islamic *Sharia* basic needs of the society (i.e certain important functions & jobs etc) are to be availed by some members of society. If they are not, then the whole society is in sin, until it arranges the procurement of teachers, doctors, bankers ...etc. it is a responsibility bestowed on every one. Furthermore, the institution of Wagf, an organization reserved for social services and financed by donation, flourished in Muslim societies to the point where there were trusts for even feeding birds let alone caring for the elderly and providing for the needy etc. It used to be that educational and legal institutions are financed not by government but by these Wagfs, an ingenious way of preserving their independence. But surely government would still need money ! Islamic scholars bent towards " smaller government" one that is in no way a burden on

people. They went so long as to allow borrowings ⁽⁹⁾ rather than taxing. They looked at taxes as a deterrent to economic prosperity. For social purposes Zakah should suffice. In case of emergency, government should call upon people to donate, it can borrow if need be. But taxes are a measure of last resort. It goes without saying that the circumstances social, political, economical and that of technology that today are completely different from that which were present few centuries ago. One may agree, that the state as we know it today can't function without taxation, proceeds of which are used not to enrich rulers & princes but to finance projects for the good of the whole society, such as law & order and economic development, social insurance & preventive health services. *Sharia* is unique in ability to remain relevant to the actual needs of society even as circumstances change. *Sharia* sets priorities & classification objectives. It very clearly distinguishes between ends & means and hence it must be judged on this scale. If the ends can be achieved with alternative means, then taxation is rejected. If the end can not be reached without this means it becomes imperative because what we need to care about is the end.

Notes:

- (1) In Islamic Jurisprudence, one is not relieved of the objection of Zakah until he is sure it is possessed by the poor. If it was used for any purpose without satisfying this condition it is not considered as Zakah.
- (2) It is even not allowed, without goods reasons, to slaughter the milking goat because it is considered as an asset.
- (3) It is permitted to donate, by the deceased, no more than one third of bequest to purposes of his choice. However, these purposes to be charitable and not to certain individuals.
- (4) It is mentioned in the Koran that the hell fire is waiting for those who hoard money.
- (5) Prophet Mohamad (PBUH) ordered his companions to sell dates of low quality and use the money to buy goods ones rather than barter.
- (6) i.e, when debt is specified it is not allowed to increase it even in case where debtor delaying payment. He can be punished by not financially. Debt obligation has to be specific amount of money or any fungible.
- (7) This is well known in the literature of theory of agency. The more you reduce the effect of the information on the outcome the more effective the relations becomes.
- (8) In a recent study about the effect of studying economics, in particular, the effect of exposing college students to the postulate of self-interest in individual behavior, it was shown that economics students compared to other college students, tend to be more selfish and emulative to the homo-economic model. See: Robert H. Frank, Thomas Gilovich and Dennis T. Regan; " Does Studying Economics Inhibit Co-operation ? " ; Journal of Economic Perspectives, Vol. 7 # 2, Spring 1993, PP 159-171.

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