Journal of Islamic Banking & Finance

Global Perspective on Islamic Finance

Inside

- Shari'ah Standard of Stock Screening in the Capital Market
- The Islamic Worldview and Development Ideals
- Exploring the Significance of Islamic Environmental Ethics for Fostering Sustainable Environment
- Project-backed Sukuk: can it be a model for resource mobilization, risk sharing and capital market development in developing economies?
- Aggravating housing situation: Return and ownership issues in Islamic home financing revisited
- Privatization Predicament and Shari'ah Compliant Alternate solutions
Al Baraka Business Plus Account
get a lot MORE than just RETURNS!

CHECKING ACCOUNT FACILITIES
FREE DUPLICATE BANK ACCOUNT STATEMENTS
FREE E-STATEMENT
FREE SMS BANKING
FREE FIRST CHEQUE BOOK
FREE DEBIT CARD
FREE INTERNET BANKING
FREE ONLINE BANKING TRANSACTIONS
FREE HOLD MAIL FACILITY
FREE PAY ORDER
SHARI'AH COMPLIANT

Your Partner Bank
Al Baraka Bank (Pakistan) Limited
In The Name of Allah,

The most Beneficent, The most Merciful

“O Believers: devour not Riba, doubled and redoubled;

and fear Allah, in the hope that you may get prosperity.”

Sura Ale-Imran (verse No. 130)

---------------------------------------------------------

The articles published in this Journal contain references from the sacred verses of Holy Qur’an and Traditions of the prophet (p.b.u.h) printed for the understanding and the benefit of our readers. Please maintain their due sanctity and ensure that the pages on which these are printed should be disposed of in the proper Islamic manner.
<table>
<thead>
<tr>
<th></th>
<th>CONTENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Editor’s Note .......................................................................................................................07</td>
</tr>
</tbody>
</table>
| 2. | Shari'ah Standard of Stock Screening in the Capital Market .................................11  
   By Prof. Dr. Mohd Ma'Sum Billah |
| 3. | The Islamic Worldview and Development Ideals .........................................................33  
   By Junaid Qadir |
| 4. | Exploring the Significance of Islamic Environmental Ethics ................................55  
   for Fostering Sustainable Environment  
   By Dr. Salman Ahmed Shaikh |
| 5. | Project-backed Sukuk: can it be a model for resource mobilization, ..........68  
   risk sharing and capital market development in developing economies?  
   By Bukhari M. S. Sillah |
| 6. | Aggravating housing situation: Return and ownership issues ....................84  
   in Islamic home financing revisited  
   By Professor Dr. Zubair Hasan |
| 7. | Privatization Predicament and Shari’ah Compliant .................................................94  
   Alternate solutions  
   By Malik Shahzad Shabbir |
| 8. | Country Model: Maldives ..................................................................................................103 |
| 10. | World Governance Indicators ......................................................................................107 |
Advantedge & Partners (Pvt) Ltd is a diverse and effective consultancy offering business development services, training, coaching and other value added human resource development services to help individuals and organizations realize their maximum potential.

For more information: Visit our website www.advantedge.com.pk
Editor’s Note

The global Sukuk market is mainly led by Malaysia and GCC. It is important to have stable economic and political stability in the Middle East for the global Sukuk issuance to grow. In recent times, the governments in non-OIC countries have also taken interest in issuing Sukuk. The continuation of this trend is vital for the global penetration of Sukuk in the financial markets.

Sukuk issuance can be used in sourcing finance for a variety of needs. Corporate issuances can meet the long-term finance needs of corporations to build production capacity. Sovereign Sukuk can be used for development finance. In addition to that, sovereign Sukuk can also provide long-term macroeconomic support to the governments and enterprises by building the infrastructure for future.

Muslim majority developing countries have to push harder towards achieving the sustainable development goals. In this regard, Sukuk can be used to provide necessary funding which is required to purchase tangible fixed assets and technological infrastructure. It is known that agriculture remains the mainstay in economic structures of many Muslim majority countries. Thus, Sukuk can also be used in financing new technologies and modernizing agriculture.

Furthermore, standardization and sound corporate governance are vital in building and retaining investors’ confidence. Going forward, tax neutrality is vital for the increased penetration in the global Sukuk issuance. There is significant demand for more liquid Shari’ah compliant investment structures like Sukuk among banks and asset management companies for their treasury and portfolio management operations respectively.

Finally, innovation is also important to tap diverse markets and industries. In recent years, companies in the services sector including telecommunication, power and airline have also issued Sukuk where the underlying subject matter is a service, such as mobile cards and airline tickets, for instance. It is important to have such innovations in
structures so that Sukuk market targets other sectors beyond just the manufacturing sector.

Islamic finance is penetrating steadily in diverse segments with its rich set of product structures that are commercially sound and imbued with effective risk mitigants. Penetration of Islamic finance also requires support from the policymakers to provide a level playing field. With increased regulatory and policy support and active role of educational institutions, media and civil society, Islamic finance can make further inroads to provide an ethical and commercially competitive alternative to high-risk and usurious conventional banking.

This issue of Journal of Islamic Banking & Finance documents scholarly contributions from authors around the globe. Contributions in this current issue discuss the theoretical underpinnings of an Islamic economy, contemporary issues in Islamic finance and performance based empirical studies on Islamic banking and finance. Below, we introduce the research contributions with their key findings that are selected for inclusion in this issue.

The next article authored by Mohd Ma’sum Billah, professor Islamic Economic Institute at King Abdul Aziz University KSA, entitled “Shariah Standards of Stock Screening in the Capital Market”, takes up another lesser discussed topic. The Malaysian stock market is taken as the context and practices prevalent and acceptable under shariah are discussed. The role of Shari’ah Advisory Council (SAB) of the Securities Commission (SC) is discussed in screening of individual company scrips in determining which are halal and which not.

“The Islamic Worldview and Development Ideals” by Junaid Qadir who is affiliated with Information Technology University, Punjab, Lahore, Pakistan talks of the concept of development and progress depending upon the belief and value systems of the human population at large. He compares the broad worldviews as presented by neoclassical economics and that by Islam. He cites Quranic verses to support his argument. He presents that in the Islamic worldview, human life is purposeful, and human development can only be meaningfully measured in the backdrop of this purpose - the Islamic direction being of collective good. That of neoclassic economics is, he says, individualistic and hedonistic. This is a very interesting and informative piece which explains very well the difference between western and generally followed economic theory and that which Islam teaches.

The article entitled “Exploring the Significance of Islamic Environmental Ethics for Fostering Sustainable Environment” contributed by Dr. Salman Ahmed Shaikh, In this paper, he discusses the implications of Islamic worldview and
environmental ethics in creating more commitment and environment friendly sustainable co-existence with nature. He discusses that the theistic concepts of Tawheed, Khilafah and Akhirah govern the Islamic way of life. Belief in a single source of creation defies racial, ethnic or gender basis of biases.

“Project-backed Sukuk: can it be a model for resource mobilization, risk sharing and capital market development in developing economies?” Contributed by Bukhari M. S. Sillah, ERPD, Chief Economist Complex Islamic Development Bank, is a well thought out and articulated piece discussing the Islamic Financial Instrument of Sukuk. Sillah discusses in very pertinent detail the difference between asset backed and asset based Sukus, the Shariah relevance, the advantages and risks in both and why one or the other is preferable in specifically transactions. He cites statistics and cautions against Islamic Banks mimicking conventional banks by use of quasi Islamic modes while in actual fact true Islamic instruments are available if properly understood and judiciously used. He talks about the suitability of Sukuk for public sector projects.

Zubair Hasan, revisits his Zubair Diminishing Balance Model of calculating housing finance installments presented in ISRA journal of June 2013. In his article “Aggravating housing situation, Return and Ownership in Islamic Housing Finance”, Zubair attempts to respond to criticism that the ZDBM does not fully address the compounding issue of profit in the installments. He argues that it does indeed do so and shows the same through calculations.

“Privatization Predicament and Shari‘ah Compliant Alternate Solutions” contributed by Malik Shahzad Shabbir, affiliated with University of Brunei Darussaalm and Tasmia Matloob who is affiliated with International Islamic University, Islamabad, discusses how the use of Islamic Financial instruments can help governments avoid privatizing essential entities and national assets which they have to resort to so as to solve their liquidity problems and bring in operational efficiencies. The authors present the topic in context of Pakistan and especially the State Owned Sui Southern and Northern Gas Companies. They discuss the viability of the modes of Musharaka, Ijara and Sukuk as Islamic Finance Instruments that can be used to preserve national assets under the public umbrella and achieve the liquidity to make them more viable.
Disclaimer

The authors themselves are responsible for the views and opinions expressed by them in their articles published in this Journal.

The opinions, suggestions from our worthy readers are welcome, may be communicated on

E-mail: ia_ib@yahoo.com,
Facebook: http://www.facebook.com/JIBFK, Website:
www.islamicbanking.asia
Shari'ah Standard of Stock Screening in the Capital Market

By
Mohd Ma’Sum Billah, PhD*

Abstract:
Any activity be it a trade or manufacturing or service from viewpoint of Halal (legitimate) gain or income generation, should be in total compliance with the integrated Divine principles of Shari’ah (and that is; law, morality and cooperation with utmost care, share and concern with holistic universal character for the common benefit of all humanity by waiving the issue of one’s religion, race, colour, gender, status or nationality). An unfair gain through dishonesty, misappropriation, oppression, illegality and appreciating advantage at the expense of others, is totally opposed and against the concept and spirit of halal (legitimacy). In the capital market of Malaysia under the Shari’ah principles, the screening mechanisms or processing is strictly required to comply to the Shari’ah standard and approved guidelines to make one Halal. In this paper an attempt is made to examine the capital market, its stocks, screening process and other related issues under the Shari’ah principles as adapted in Malaysia.

Keywords: capital market; stocks; sukuk; Islam; Shari’ah; halal; screening; compliance.

1. Introduction

Investment in the capital market under the conventional economy involves (in many situations) usury and gambling, manufacturing and / or selling of non-Shari’ah products (for example, liquor, pork and pornography related materials), engaging in

* Author: Professor (Finance, Insurance, Investment, Capital Market & Trade), Islamic Economics Institute, King Abdul Aziz University, Saudi Arabia.
(e-mail: profdrmasumbillah@yahoo.com), blog: www.drmasumbillah.blogspot.com
operations evolved by the elements of uncertainty and cheating, which are forbidden by the Shari’ah. These activities are considered as un-Islamic (non-Halal) in nature, as regulated by the Shari’ah frameworks. Therefore, the stocks and shares of companies involving in the above-mentioned practices are deemed non-halal. But, what if the core business of a company is halal in nature, while a smaller portion of the business activities are not aligned with the Shari’ah principles. Can such a company or its activities be regarded Halal? Or is it Halal to invest or participate in the above nature of companies or their activities? Or what are the Shari’ah screening mechanisms to determine one is Halal?

To resolve the above queries, this paper will first give an overview of the Malaysian capital market followed by the step-by-step process of evaluating companies for the purpose of determining whether or not a company’s stock is considered as halal. Then, we will look at the criteria of disapproved stocks, that is, stocks which are not allowed to be purchased by Muslims because of their un-Islamic nature. Subsequently, we will discuss the case of investing in mixed companies (companies which are involved in both halal and non-halal activities). Finally, some Shari’ah related issues on stock trading and practices such as preference shares, contra trading, insider trading, margin trading and short selling of stocks are analysed.

2. Literature Review

There are a series of researches basically on the general issues and the growth of Islamic capital market in Malaysia. Those researches are classified in to (a) the theoretical analysis, (b) possible practical solutions (c) while the 3rd category is a mixture of both theoretical and the practical approaches. It has been observed that, the screening process of the Halal stocks has not so far been comprehensively analysed except through some fundamental touches for instance; Hakim and Rashidian (2002) used a co-integration technique in comparing the performance of the Dow Jones Islamic Market Index (DJIMI), with Wilshire 5000 Index using data for period 10/12/1999 - 9/4/2002. Their findings concluded that on a risk-return basis, there is no loss from the screening exercise used for DJIMI stocks, and Islamic investors are not restricted in investing in an Islamic index as a global larger market avenue.

3. Overview of the Malaysian Capital Market

The following are the components in the Malaysian capital market and its governing bodies:

---

The caption of the above structure is as follows:

Stocks are traded on the Kuala Lumpur Stock exchange (KLSE) and Malaysian Exchange of Securities Dealing and Automated Quotation is known as (MESDAQ). To buy and sell shares, these are routed to the Securities Clearing Automated Network Services Sdn Bhd (SCANS), which plays a role in the delivery and settlement of shares, and also in receiving and paying the amount payable to or by stockbroking firms. On the other hand, the issuing house facilitates the issuance of new shares for sale to the public. To trade in the KLSE listed companies, a person has to first open a trading account and a Central Depository System (CDS) account with one of the stockbroking companies. The CDS uses book entry system to keep track of movement of shares traded; thus, no physical delivery of shares is present under the CDS.

While the Bank Negara supervises the trading of bond securities, the Malaysia Derivatives Exchange Bhd (MDEX) facilitates the trading of the following contracts that are traded on an electronic screen based system:

i. Kuala Lumpur Stock Exchange Composite Index (KLSE CI) Futures or FKLI;
ii. Kuala Lumpur Stock Exchange Composite Index (KLSE CI) Options or OKLI;
iii. Crude Palm Oil (CPO) Futures or FCPO;
iv. 3-Month Kuala Lumpur Interbank Offered Rate (KLIBOR) Futures or FKB3;

---

5 "Role of derivatives in the financial world" (2002), *The Star (Business Section)*, 15th July, p. 9.
5. 5-Year Malaysian Government Securities (MGS) Futures or FMG5.

The Malaysian Derivatives Clearing House (MDCH) on the other hand plays a role in registering, monitoring, matching, guaranteeing and carrying out the financial settlement of futures and options transactions traded on the MDEX.⁶

4. **Process of Evaluating Stocks**

There are three categories or status of companies:

- Non-permissible activities
- Activities comprise of both permissible and non-permissible activities
- Permissible activities

Companies under the category of non-permissible (permissible) activities are those who are involved in the non-**halal** (**halal**) activities, under the Shari’ah principles. While activities comprising of both permissible and non-permissible activities means that the companies under this categories are performing both *halal* and non-*halal* activities.

To determine whether or not a Muslim can buy and sell stocks issued by companies listed in the KLSE, the following process needs to be fulfilled beforehand:⁷

The illustration on the above processes are as follows:

---

4.1 Collecting Data on Stocks or Companies

The Shari’ah Advisory body (SAB) of the Securities Commission (SC) receives input and support mainly from the SC itself. The SC gathers information on companies’ activities from various sources such as annual financial reports, and published information in magazines, newspapers and KLSE references. Apart from that, the SC also conducts surveys and interview sessions with respective companies’ managements.

4.2 Evaluation and Preparation of Report

Upon evaluation of data, if the Shari’ah Advisory Body (SAB) is satisfied that the evaluated companies are engaging in halal (permissible) activities, then the stocks of these companies will immediately be approved (can be purchased by Muslims); the opposite holds for companies engaging in non-halal activities only. On the other hand, if the companies’ activities comprise of both permissible and non-permissible elements, the SAB will then perform two additional phases of evaluation.

4.1.1 The first phase adopts quantitative method of evaluation. The SAB will calculate the percentage of contribution or ratio of haram activities to the turnover of group accounts and to the profit before tax of group accounts.

4.2.2 The second phase applies qualitative method of evaluating companies, that is, looking at the society or public perception of the companies, and determining the importance and maslahah (benefit) of these companies to the ummah (nation); the haram element only involve matters such as ‘uruf (custom), ‘umum balwa (common plight), and fasad al-zaman.

4.3 Report will be presented to the Shari’ah Advisory Body (SAB)

After conducting thorough evaluation of companies’ activities, the report will be forwarded to the SAB Board of the Securities Commission (SC) for approval.

4.4 Announcement of Shari’ah approved stocks

Finally, the list of stocks approved as halal by the SAB of the SC will be updated and made known to the public by the Security Commission.

5. Criteria of Disapproved Stocks

As mentioned earlier, the main criteria for halal stock is that the business of the company issuing the stock must be in accordance with the Shari’ah principles. Stocks of listed companies will be excluded from the list of Shari’ah approved stocks based on the following criteria:

5.1 Operations of companies based on riba (interest);

5.2 Operations of companies involving in gambling;

---

8 Ibid., p. 3.
9 Yahya, H., (1999), Approved Securities by Shari’ah, presented at Securities Commission on 19th May, p. 3.
5.3 Operations of companies involving in the manufacturing and/or selling of *haram* products;

5.4 Operations of companies containing element of *gharar* (uncertainty).

### 5.1 Operations of companies based on Riba (usury)

Operations and activities of financial institutions, including commercial and merchant banks, and finance companies are generally known to be based on *riba*. It is noteworthy to state here that Islam permits increase in capital through trade. *Allah* says:

> "O you who believe, do not consume your property among yourselves wrongfully, but let there be trade and traffic by mutual consent..."\(^{11}\)

At the same time, Islam prohibits anyone who tries to increase his or her capital through lending on *riba* (usury or interest) whether it is at a low or a high rate. The Holy Prophet (SAW) declared war on usury and those who dealt in it. He said:

> "When usury and fornication appear in a community, the people of that community render themselves deserving of the punishment of *Allah*."

The main purpose for prohibition of *riba* in transactions is, that it discourages people from doing good to one another, as required by Islam. If interest is prohibited in a society, people will lend money to the needy at goodwill, that is, expecting the same amount of money lent to be returned by the borrower. If interest is made permissible, the needy will then be burdened by the requirement to pay back more than the amount he or she borrowed.\(^{13}\) Below are hypothetical examples of companies involving in *riba* based transactions:

Dynamic Finance Berhad is a company, which provides financing to businessman. The company will charge fixed interest for every loan they provide and interest is the main income for this organization. As a result, Muslims are prohibited to make any investment in this type of company. *Allah* says in Al-Qur’an:

> "...*God hath permitted trade and forbidden usury*..."\(^{14}\)

Another example is a company, Mega First Corporation Bhd., which involves in producing textile. At the same time, the company deposits its surplus in an interest-bearing account, and borrows money (on interest) from Hong Leong Bank Bhd. In this case, according to Justice Mufti Muhammad Taqi Usmani, a Muslim can purchase the shares of joint stock company (mixed company) with the following conditions:\(^{15}\)

5.1.1 The main business of the company must be *halal* according to *Shari’ah*.

---


\(^{11}\) Al-Qur’an, *al-Nisa* : 29.


\(^{13}\) *Ibid* p. 266.


5.1.2 If the main business is \textit{halal}, but it involves in borrowing money on interest or placing its funds in interest-bearing account, a Muslim shareholder should raise his voice against this practise in the annual general meeting of the company.

5.1.3 When a Muslim shareholder receives a dividend, he must ascertain the proportion of the profit of the company coming from the interest-bearing account. Then, the same proportion of his own dividend must be given to a person or persons entitled to receive \textit{zakat}.

The proportion of dividend attributed to the interest-bearing account must be given to charity and must not be retained by the shareholder.\footnote{16} This is called the act of purification or dividend cleansing for Muslim investors who wish to invest in mixed companies (activities involving both \textit{halal} and non-\textit{halal} elements).

In order to allow Muslims to invest in mixed companies, different scholars have come up with different percentages of allowable non-\textit{Shari'ah} compliant sources of income. According to IslamiQ's Screen IslamiQ methodology, a Muslim investor cannot invest in the shares of a company if the non-\textit{Shari'ah} compliant sources of income contribute 5\% or more of the company's total income. IslamiQ's Screen IslamiQ also stated that the shareholder must express his or her disapproval against such dealings, preferably by raising his voice against such activities in the annual general meeting of the company.\footnote{17} Meanwhile, other scholars think that if a business has 25\% or less (some even said 33.3\%) of its total income coming from interest-bearing activities, then Muslims are allowed to invest in that business, provided they (the investors) get rid of the interest based portion of the income by giving it away to the poor and needy or for charity.

\subsection*{5.2 Operations involving in gambling}

Gambling is a clear case of chance transaction whereby there is no possibility of predicting the outcome. The wisdoms behind the prohibition of gambling are as follows:\footnote{18}

5.2.1 Gambling, which includes raffling or the lottery makes a person dependent on chance, luck and empty wishes, thus, taking that person away from serious work and productive efforts.

5.2.2 In Islam, an individual’s property is sacred and it may not be taken away from the owner except through lawful exchange, or unless he or she gives it freely as a gift or for charity. Accordingly, taking property from a person who lost in gambling is unlawful.

In one of the hadith reported by \textit{Ibnu Majah}, Prophet (SAW) said:

\begin{quote}
"He who says to his friends, “Come let us gamble”, must give charity."
\end{quote} \footnote{19}

\begin{footnotes}
\item[16] Interview with Endut, G., (2003), Assistant Director of \textit{Shari'ah} Division in Bank Islam Malaysia Berhad (BIMB) on 25\textsuperscript{th} May.
\item[17] Seen on 24\textsuperscript{th} of February, 2016: http://www.islamiQstocks.com.
\end{footnotes}
For instance, Genting Highland Bhd. is one of the largest and well-known casinos in the world, and their core activity is totally based on gambling activities. Consequently, Muslim investors are totally prohibited from buying shares of such company. The Islamic teachings urge the Muslims to follow Allah’s directives for earning a living, and clearly, Islam prohibits gambling as a mean of earning a living. Allah says:

“O you who believed! Truly, intoxicant and gambling and divination by arrows are an abomination of Satan’s doing: avoid it in order that you may be successful. Assuredly, Satan desires to sow enmity and hatred among you with intoxicants and gambling, and to hinder you from the remembrance of Allah and from salat. Will you not then desist?”

5.3 Operations of companies involving in the manufacturing and /or selling of haram products

In Islam, products such as liquor, pork and meat that are not slaughtered according to Islamic rites are haram (forbidden). Accordingly, trading in these goods is haram. Other examples of haram trading items are idols, crosses, and statues. Permitting the sale or trade of such articles implies promoting and propagating them among people, and consequently encouraging them to do what Islam prohibits. The prophet (SAW) said:

“surely, Allah and His messenger have prohibited the sale of wine, the flesh of dead animals, swine and idols”

The Prophet did not stop at prohibiting the drinking of alcohol, whether much or little but he also forbade any trading in it, even with non-Muslim. It is not permissible for a Muslim to import or export alcoholic beverages, or to own or work in a place, which sells them. In connection with alcohol, the prophet (SAW) cursed ten categories of people, saying:

“ Truly, Allah has cursed Wine (Khamr) and has cursed the one who produces it, the one for whom it is produced, the one who drinks, the one who serves it, the one who carries it, the one for whom it is carried, the one who sells it, the one who earns from the sales of it, the one who buys it, and the one for whom it is bought.”

This principle also applies to drugs trading because the intoxicating effects of drugs are considered the same as alcohol. Moreover, the deeply addictive nature of drugs, and their effects on ones health, finances, family and society are also reasons why drugs are considered as haram. However, drugs trading are only permissible if the drugs will be use for medication purposes.

19 Ibid., p. 304.
Guinness Corporation Sdn Bhd, for example, involves in selling and producing of alcoholic beverages. Thus, clearly, the share of the company is *haram* and cannot be bought by Muslims investors. Take another example, Garfield Sdn Bhd, a company involving in buying, rearing and selling pigs. It is well known that pork is very dangerous to human. Scientific research has shown that eating pork is injurious to health in all climates especially hot ones. This is because pork carries a deadly parasite (*trichina*) that could harm those who eat it. In addition to this, there are also some scholars who say that eating pork frequently can diminish the human being’s sense of shame in relation to what is indecent. These are the reasons why *Allah* prohibits eating pork. *Allah* (SWT) says:

*Say (O Muhammad SAW): “I find not in that which has been revealed to me anything forbidden to be eaten by one who wishes to eat it, unless it be a dead animal or blood poured forth), or the flesh of swine (*pork*) for that surely is impure, or impious meat (of an animal) which is slaughtered as a sacrifice for others than Allâh.”* 25

### 5.4 Operations containing element of gharar (uncertainty)

*Gharar* or doubtful transaction is the basis for gambling and hence prohibited. A doubtful or uncertain transaction will obviously result in some unfair or unjust outcome to any of the parties involved. For example, insurance against hazards whereby the insured pays a specified premium during the year. If no accident of the type specified in the insurance policy occurs to the property during the year, the company keeps the premiums received and nothing is returned to the insured. If, on the other hand, some calamity occurs, the insured individual is paid the agreed-upon sum. This kind of transaction involves *gharar* since there is no principle of profit-sharing. The doubt or uncertainty here lies in the fact that no one knows whether something may or may not happen. This example again signifies the desire of the Islamic *Shari'ah* to ensure justice to all parties. It is interesting to note that the Islamic way of establishing justice closes all doors of injustices right from the start rather than to allow it to happen and confronting with the reactions or punishments later.

However, not every sale involving what is unknown or uncertain is prohibited. For instance, a person may buy a house without knowing the condition of its foundation. Here, if the risk of uncertainty can be determined by experience and custom, the sale is not prohibited. In the opinion of Imam Malik, all sales of needed item in which the margin of risk is bearable are permissible. For example one may sell root vegetables such as carrots, onions, and radishes while they are still in the ground. Ibn Taymiyyah said the principle laid down by Imam Malik concerning these type of sales are superior to those of others, because he took them from Sa’id Ibn Al- Musayyib, who is in the best of authority on the *fiqh* of sales. 26

---

Take an example of a company, Doraemon Company Bhd, which is a conventional based insurance company. It offers a variety of insurance schemes such as life insurance, fire insurance, accident insurance and so on. As a result, a Muslim investor cannot make any investment in this type of company. Many scholars have held that Insurance, in its present is prohibited, since you are paying money for something that may or may not happen. The insurer takes the premium money, and in most cases gets to keep them all (except for cases when too many claims occur, the insurer may end up with a loss). This imbalance is unfair, and has led to the prohibition of the present conventional insurance policies. An alternative policy, which is acceptable in Islam, would be the Cooperative Insurance (Takaful) where all participants co-own the pooled premiums. The pooled fund is invested, and any claims from participants are settled using the pooled fund. Any profit from investment (less all claims and allowable costs) is then distributed among the participants at the end of the period or fiscal year.

6. Investing in Mixed Companies

As in the case of mixed companies, whereby the activities comprise of both permissible and non-permissible elements, the SAB of the SC applied several additional criteria, which are:26

6.1 The core activities of the companies must be activities, which are not against the Shari’ah (as outlined above). Furthermore, the haram elements must be small compared to the core activities;

6.2 Public perception or the image of the companies must be good; and

6.3 The core activities of the companies have important maslahah (benefit in general) to the nation and the country, and the haram elements are very small and involve matter such as ‘umum balwa, ‘uruf and the right of the non-Muslim community, which are accepted by Islam.

There are a number of opinions coming from Muktabar scholars pertaining to the issue of mixed companies whereby Muslims and non-Muslims jointly share management of a company:27

Abu Yusof said that it is makruh for Muslims to have a company with non-Muslims. Both are allowed to exercise the company’s activities on their own, even though the activities are different. However, Muslims are prohibited from dealing with non-halal activities but not for the non-Muslims.

Maliki school of Islamic jurisprudence also confirmed that it is makruh to share a company with the non-Muslim. This opinion was based on the opinion of Al-Hattab and Ibn Hajjib, saying that a true Muslim should not co-operate with Yahudi, Nasrani and fajir Muslims in business activities, unless the Muslims control the management.

26 Yahya, H., (1999), Approved Securities by Shari’ah, presented at Securities Commission on 19th May, p. 5.
27 Ibid., p. 6.
Shafie and Hanbali schools of Islamic jurisprudence pointed out that it is makruh because we are not sure whether the non-Muslims exercise prohibited activities or not.

Imam Hanafi (the founder of the Hanafi school of Islamic jurisprudence) and Muhammad held such practice to be la yajuz because non-Muslims are permitted to generate wealth from haram activities, while Muslims are not allowed to do so.

The rationales behind the approval of making investment in mixed companies are:

‘Umum Balwa[^28] (common plight or excuse), which is practised by Hanafi school, is a situation of unavoidable difficulty whereby the non-halal activities are untraceable, or when halal and haram are in separable because of necessities. An example would be the riba’ practicing by all financial institutions in the world nowadays (this was supported by Al-Qaradawi). Many financial institutions’ activities are involved in riba’ which has become a common balwa. Companies are not able to avoid this haram element since they have to borrow money from these institutions to ensure their survival. However, for companies involving in other haram activities like gambling or producing liquor, investors must avoid them since there are other alternatives such as investing in food or agricultural industries.

Dharuriyat al-khamsah[^29] whereby Muslim investors are allowed to invest in mixed companies to ensure that they won’t be left behind non-Muslims. According to scholars, Muslims are allowed to invest in mixed companies as long as the core activities of the companies are halal and the percentage of haram activities is very small. Muslims can purchase these companies’ stocks, provided that they have gone through the cleansing process whereby income from non-halal activities are properly proportioned to be given to charity.[^30]

Sins cannot be transferred from one person to another.[^31] Allah says:

“Say: "Shall I seek for my cherisher other than God, when He is the Cherisher of all things (that exist)? Every soul draws the meed of its acts on none but itself: no bearer of burdens can bear the burden of another. Your goal in the end is towards God: He will tell you the truth of the things wherein ye disputed.”[^32]

According to Al-Khayyat, the sins of interest in muamalat are the responsibility of the management board.[^33] So, the investors do not have to further inquire about this matter.

[^28]: Ibid., p. 8.
[^29]: Ibid., p. 9.
[^32]: Al-Qur’an, al-An’am: 164.
[^33]: Yahya, H., Supra, p. 9.
Changes in rules,\(^{34}\) which occurred because of the changes in human nature. The changes were due to several reasons, that is, fasad al-zaman, asalib iqtisadiyah and changes in period. For example, according to Dato’ Haji Hashim Yahya, during the earlier days, religious teachers taught for the sake of fulfilling their obligations towards the society. However, nowadays because of the changes of the environment, there is an increase in demand for religious teacher. Thus, this duty has now become a profession and they are paid for their services.

Even though Islam has determined what is halal and what is haram, it also takes into consideration human weaknesses and capacity. Under the compulsion of necessities, Islam even permits Muslims to eat prohibited food in quantities sufficient to reduce starvation and save him from death. Allah said in Al-Qur’an:

> “...But if one is compelled by necessities, neither craving nor transgressing, there is no sins on him; in deed, Allah is forgiving merciful."\(^ {35}\)

Furthermore, a legal maxim provides to the effect:

> “If the good and bad things are mixed together then make a considered decision.”\(^ {36}\)

Therefore, we can see that Islam is actually a very flexible religion and it does not bring about detriments or disadvantages to its worshippers. Even when an item or practice is said to be impermissible in the first place, due to necessities and unavoidable difficulties, for example, the impermissible can then be made permissible, but careful and thorough evaluations need to be done in advance. Furthermore, in Islam, the impermissible can be made permissible if the benefits are greater than the harmful effects arising from the non-halal elements.

7. Method for evaluating mixed companies

The evaluation of mixed companies involves two stages:\(^ {37}\)

7.1 The first stage involves quantitative analysis of the companies. Firstly, the turnover (TO) and profit before tax (PBT) of the group consolidated accounts and the non-halal activities of mixed companies are obtained. Then, the ratios of the TO (and/or PBT) of the non-halal activities over the TO (and/or PBT) of the group consolidated account are calculated. The ratios are then compared to the benchmark (the acceptable level of the contribution of non-halal activities to the group earning income, which is determined by the SAB). If the ratios of the companies are lower (higher) than the benchmark, then the SAB will approve (disapprove) the purchasing of these stocks by Muslims.

---

\(^{34}\) Ibid., p. 8.

\(^{35}\) Al-Qur’an, al-Baqarah: 173

\(^{36}\) Legal Maxim

\(^{37}\) Ruslin, N., Supra, p. 3.
7.2 The second stage involves qualitative analysis of the companies. As mentioned earlier, SAB will look at the areas of maslahah, ‘uruf and ‘umum balwa with regard to these companies. The qualitative analysis is very subjective; depending on the case, the SAB will make the decision whether or not Muslims can purchase the stocks of the mixed companies.

For further understanding, some cases are highlighted below:

The first case involves a holding company, Ladang Utama Berhad, whose core activities are in the area of plantation and investment. On the other hand, its subsidiary, Gaming Bhd is involved in gambling activities. The following are the information obtained from the accounts of the holding company and its subsidiary:

<table>
<thead>
<tr>
<th>Group account</th>
<th>Gaming Bhd</th>
</tr>
</thead>
<tbody>
<tr>
<td>TO</td>
<td>PBT</td>
</tr>
<tr>
<td>RM 1,000,000</td>
<td>RM 100,000</td>
</tr>
</tbody>
</table>

The screening result is as follows:

Ratio of calculation:

7.2.1 Contribution of non-halal activities to the Group’s turnover:

$$\text{TO Gaming Bhd} \quad \frac{\text{RM 55,000} \times 100\%}{\text{RM 1,000,000}} = 5.5\%$$

7.2.2 Contribution of non-halal activities to the Group’s PBT:

$$\text{PBT Gaming Bhd} \quad \frac{\text{RM 4,500} \times 100\%}{\text{RM 100,000}} = 4.5\%$$

5.5 % (the higher percentage) will be compared to the benchmark of 5% as determined by the SAB.38 Since 5.5% is higher than the benchmark, the holding company’s stock will be rejected.

The second case involves the operation of banking activities by associate company: the core activity of High Resources Bhd (the holding company) is producing industrial products, while Krypton Merchant Bank Malaysia Bhd (an associate company) is involved in banking activities. The PBT of High Resources Bhd and the profit portion attributed to Krypton Merchant Bank Malaysia Bhd are RM 10,000,000 and RM 1,250,000 respectively.

Ratio of calculation:

7.2.3 Contribution of non-halal activities to the Group’s turnover:

$$\text{Profit from Krypton group’s PBT} \quad \frac{\text{RM 1,250,000} \times 100\%}{\text{RM 10,000,000}} = 12.5\%$$

---

38 Ibid., p. 5.
12.5% will be compared to the Shari’ah’s benchmark to determine whether the holding company’s stock is approved or not.\(^{39}\)

The third case is regarding subsidiary’s involvement in hotel and selling of haram product (alcohol). The holding company, Singgahsana Holding Bhd, is engaging in investment activities. Its subsidiary, Crest Prince Hotel Bhd manages a hotel and sells alcohol. The information obtained is as follow:

*Singgahsana Holding Bhd:*

- **TO:** RM 10,000,000
- **PBT:** RM 2,500,000

*Crest Prince Hotel Bhd:*

- **TO:** RM 2,100,000
- **PBT:** RM 230,000

*Selling alcoholic beverages:*

- **TO:** RM700,000
- **PBT:** RM55,000

**Ratio calculation:**

The first step is to compute the contribution from hotel activity.

7.2.4 Contribution of hotel activity to Group’s TO:

\[
\text{Crest Prince’s TO} \quad \text{Group’s TO} \quad \frac{\text{RM 2,100,000}}{\text{RM 10,000,000}} \times 100\% = 21\%
\]

7.2.5 Contribution of hotel activity to Group’s PBT:

\[
\text{Crest Prince’s PBT} \quad \text{Group’s PBT} \quad \frac{\text{RM 230,000}}{\text{RM 2,500,000}} \times 100\% = 9.2\%
\]

If the above-calculated ratio is below the Shari’ah’s benchmark of 25% (as determined by the SAB) for hotel activities, then we proceed to the next step.\(^{40}\)

The second step is to calculate the ratio for selling of alcoholic beverages.

7.2.6 Contribution of the non-halal element to the Group’s TO:

\[
\text{TO from selling alcohol} \quad \text{Group’s TO} \quad \frac{\text{RM 700,000}}{\text{RM 10,000,000}} \times 100\% = 7\%
\]

7.2.7 Contribution of the non-halal element to Group’s PBT:

\[
\text{PBT from selling alcohol} \quad \text{Group’s PBT} \quad \frac{\text{RM 55,000}}{\text{RM 2,500,000}} \times 100\% = 2.2\%
\]

If the ratios calculated above (whichever higher) turn out to be above the benchmark determined, then the stock of the holding company will be rejected.\(^{41}\)

\(^{39}\) Ibid., p. 6.

\(^{40}\) Ibid., p. 7.

\(^{41}\) Ibid., p. 7.
The fourth case is about income coming from fixed deposits. A holding company, Brown Sugar Bhd, whose core activity is in manufacturing sugar has two subsidiaries: Manis Purnama Sdn Bhd, involving in exporting sugar and Madu Kembang Sdn Bhd, involves in foods manufacturing. The Group’s earning is RM 1,000,000 and out of that, the interest income from conventional fixed deposits is RM 120,000.

7.2.8 Ratio of calculation:

\[
\frac{\text{Interest income}}{\text{Group’s earning}} \times 100\% = \frac{120,000}{1,000,000} = 12\%
\]

This rate will then be compared to the Shari’ah’s benchmark.\(^{42}\)

The fifth case demonstrates a situation whereby a Muslim holding company, Rafidi & Adrin Sdn Bhd, whose core business is in producing sugar, has a subsidiary. The subsidiary, Fong Sai Yuk Sdn Bhd, is a non-Muslim company and is involved in exporting sugar. Since both the holding and subsidiary companies operate in halal activities, the SAB Board declared the stock of the holding company as halal, even though the subsidiary company is managed by non-Muslim.

In another hypothetical case, a Muslim holding company, Brown Sugar Bhd, whose core activity is in producing sugar has a subsidiary. The subsidiary, Manis Purnama Sdn Bhd, is a non-Muslim company, selling alcohol to customers. Therefore, to determine whether or not Muslims can purchase the stock of the holding company, the ratio calculation (as shown in examples above) will have to be carried out beforehand, and then compared to the benchmark given by the SAB.

8. Confusion and Clarification Over the Stock Market

8.1 Gambling in the Stock Market

Some people believe that the stock market is a place where they can try their luck and gain substantially from the increment in stock prices, just like spending money in casinos. They think that all they have to do is just to purchase any stock they want and then sit back and wait, hoping for the profits to come rolling into their pockets sometime in the future.\(^{43}\) If this is the case, then trading in the stock market is prohibited according to the Shari’ah principles.

The question now is, are all activities in the stock market similar to gambling activities? Although one may gamble in the stock market and gain from buying and selling of stocks, in the long run the gambler will always lose.\(^ {44}\) With this in mind, anyone who wishes to participate in the stock market should prepare oneself with the knowledge and ability to analyse the market trends and financial data of companies in order to reduce the level of uncertainty of stock price movements and to gain from buying and selling of stocks. Therefore, in contrast to a gambler’s behaviour of waiting

\(^{42}\) Ibid., p. 8.
and hoping for stock prices to increase, a true investor would have analysed all available data to derive the intrinsic value of stocks and to predict the future movements of these stocks. The investor would then choose stocks, which have high probability of bringing value to his or her investment. Whilst a gambler is uncertain as to whether or not his or her stocks will appreciate or depreciate in value, a true investor is exceptionally certain that his or her stocks will indeed produce future returns. As a result, trading in the stock market is lawful under Shari‘ah principles provided that proper evaluations had been carried out prior to purchasing of stocks, and the intention to trade must not be the same as the case of gambling.

8.2 Speculation in the stock market

Aggressive strategy for investing in the stock market, that is, actively buying and selling of shares for capital gain is perceived as speculation per se. This is the reason why some Islamic scholars only approve purchasing of stocks for long-term investment; they view capital gains arising from such transaction as un-Islamic. However, Datuk Dr. Syed Othman Alhabshi argued that in any business venture one has to indulge in speculation, which is based on some prior fundamental knowledge. For example, when a person wishes to start a grocery store in a new housing area, that person would have predicted that there will be potential customers in that area, thus, giving income and profit for his business. This is actually an example of speculation but the kind, which is allowable in Islam. The kind of speculation that is unlawful in the eyes of Islam is when a person tries to outperform the others, and as a result doing harm to other people.

Referring back to the situation of aggressive buying and selling of stocks for capital gain, if adequate analysis had been carried out and if this strategy proves that there is no harm done to the rest of the stock market players, then by all means, this is acceptable in Islam. Take for example a grocery shop, where the turnover is very high. The owner buys groceries in the market at a cheaper price and sells to customers at a profit. Because of the high demand for groceries, in a day, the owner frequently visits a nearby market to restock items on the shelves. Consequently, the buying and selling activities for profits are aggressive in nature. Islam views this practice as acceptable; hence, this should also hold for buying and selling of stocks for capital gain. Datuk Dr. Syed Othman Alhabshi said that the buying and selling of shares for capital gains is completely legitimate because it is a form of business transaction involving in buying and selling of certain right over a company. He further added that when trading in stocks, one is neither dealing with interest-based transaction nor a doubtful one because the participant knows exactly what he or she buys and at a price he or she bargains for.

There are a few stock trading practices, which are perceived as un-Islamic, namely contra trading, margin trading and short selling of stocks. This is because these practices are seen to be speculative in nature. For example, in the case of contra trading, when an investor orders a remiser or dealer to buy shares, he or she has a few days to settle the

---

46 Ibid., p. 3.
47 Ibid.,
payment. Within this period, the investor might choose to sell the shares, before settling the payment due for the purchase of the stocks. If selling of the stocks produces profit (selling prices higher than purchasing prices), then the brokerage firm will pay the investor but if losses arise (selling prices lower than purchasing prices), then the investor will have to settle the differences. Some Islamic scholars hold that such trading is prohibited because it involves the element of gharar (uncertainty) and the payment for the purchase of stocks is yet to be settled.

However, other scholars view this transaction as permissible because when an investor orders the purchase of stocks through intermediaries, the order will be keyed into a system at the stockbroking company. The order will then be relayed through the system to the central computers in KLSE (for investment in stocks in Malaysia) and an order conformation will immediately be routed back to the stockbroking company; trade conformation will then be printed out at the broker’s office and the investor will then be notified. Therefore, the purchasing contract had already been concluded and the shares do belong to the investor; the only contract outstanding is the debt payment from the investor, which is a separate contract from the purchasing of stocks. Since the stocks belong to the investor, he or she has the right to keep or sell the stocks. In order to avoid defaulting on the payment. Datuk Dr. Syed Othman Alhabshi suggested that it would be preferable if investors can provide sufficient financial backing when they want to engage in contra deals.

In the case of margin trading, an investor purchases stocks by paying part of it in cash and borrowing the remainder from the brokerage firm at the margin interest rate. This practice is clearly not legitimate from an Islamic point of view because of the interest element in it. However, if the interest element can be eliminated, then such a practice is allowed. For instance, Bank Islam Malaysia Berhad tries to overcome this issue through the introduction of share financing, which adopts mudaraba profit sharing principles. The stockbroking companies can also make margin trading legal by replacing the interest element with the principles of mudaraba.

The other Islamically controversial stock-trading practice is the short selling of stocks. Under this practice, when a person foresees that a share price will fall, that person will order his or her remisier or dealer to sell the shares of the company, even though he or she does not own the shares. Later, when the price of the shares does fall, that person will purchase the stocks and close its position. This practice is clearly prohibited under the Shari’ah principles because it involves the selling of something, which the seller does not own. Some would say that this practice resembles a salam contract whereby a commodity can be sold for future delivery. Under the salam contract, the vendor has to
have paid in full for the commodity in advance, but under short selling of stocks, the purchase price is not yet known and thus cannot be paid in full. Therefore, under the Shari’ah principles, this kind of stock trading practice is prohibited due to the high level of uncertainty attributed to it.

Another issue worth mentioned under this heading is regarding insider trading activities whereby some investors obtain information, which is not easily and freely available to the rest of the stock market participants. In general, this kind of activity is prohibited under the Shari’ah because the use of privileged information enables the well-informed participants to make profits at the expense of other investors. The well-informed investors are able to manipulate the stock market in order to gain hugely from it, while causing other players to be at an unfavourable position.

### 8.3 Preference shares

According to the SAB of the SC, the approved securities include ordinary shares, warrants and transferable subscription rights (TSRs). This means that warrants and TSRs are classified as approved securities from the Shari’ah perspectives, provided the underlying shares are also approved. On the other hand, the preference shares are non-approved securities according to the SAB and many Islamic scholars.

In terms of risk, the preferred stockholders are in a less risky position than the ordinary shareholders. Preferred stockholders generally receive greater return on their investment compared to ordinary shareholders. All profits will first go to the preference shareholders according to the specified dividend rate. The remaining profits, if any, will then go to the ordinary shareholders. Even if dividends on preference shares are not given out in a particular year, the preferred stockholders are not at a loss position; they will be paid in later year (plus the dividend attributed to the current year) when the company earnings permits.

Preference shares are also given priority over ordinary shares as to the claims on company assets upon winding up of the company. Thus, in case of liquidation, the secured creditors such as bondholders are paid first, followed by preference shareholders who are paid the nominal value of their shares. Ordinary shareholders on the other hand will only receive the remaining amount available. Therefore, we can see that the preference shareholders may receive the full par value of their shares, whereas the ordinary shareholders might not. From fiqh point of view, if the preferred stockholders are to be considered as lenders, they may not receive dividend in the first place; they can only get back their principal amount lent to the companies. Alternatively, if they are considered as partners, they may not have preference over other partners, that is, the ordinary shareholders.

According to Muhammad Anas Zarqa’, a professor at the centre for research in Islamic Economic, King Abdulaziz University, Jeddah, Saudi Arabia, several fiqh rulings

---

54 Id., p. 23.
are crucial to establish the *Shari'ah* acceptability level for preference shares. Firstly, it is permissible under a partnership to agree on a profit sharing ratio, which is different from the ratio of capital invested by the partners. This rule, in strict interpretation, applies only to partnership where each partner provides some capital and some labour. The second ruling stated that it is permissible to make the profit sharing ratio in a partnership variable, depending on the level of realized profits. This second ruling was approved by the *Shari'ah* Board of the Faisal Islamic Bank of Sudan.

The shareholders, both ordinary and preferred are free to agree on any variations of the profit sharing ratios, which are different from the ordinary level (the level that corresponds to the capital investment of ordinary vs. preferred shares). The only limitation is that the profit sharing ratio must be maintained among all groups of shareholders. In other words, what must be avoided is a situation where almost all profit goes to only one group of shareholders. As a result, it should not be objectionable under the *Shari'ah* principle for a group of ordinary shareholders to give up to two thirds of their profit to another group of preferred shareholders.

### 8.4 Stock Hedging

Hedging is a useful tool for managing risks associated with the price fluctuations of share prices. Stock index futures for example, is a good hedging tool for diversified market investors because futures prices are highly correlated with the underlying market. However, the stock index futures do not have clearly defined underlying asset, thus making this tool impermissible under the principles of *Shari'ah*. In addition, this practice is unacceptable because futures allow hedgers to transfer risks to speculators; hence, futures depend on speculation. As discussed above, speculation does not necessarily portray negativity. When speculators are capable of gaining something at the expense of others, then only Islam prohibits such action. In the case of futures, speculators assume the risk of price fluctuations that hedgers try to avoid, and without the existence of speculation in the stock index futures, this tool is difficult to be put into practise. Thus, speculation in the futures has a high level of uncertainty and the speculators, in general, are willing to absorb excessive risks, hoping that they will be rewarded highly. This is akin to gambling. As a result, under the *Shari'ah* principles, the stock index futures is an unacceptable tool for hedging. Aside from that, Justice Mufti Muhammad Taqi Usmani also said that in most futures transaction, the delivery of the commodities and their possession is not intended, thus the parties end up with the settlement of difference of price only, which is not allowed in *Shari’ah*.

In the case of stock options, the buyer of the option has the right, but not the obligation, to buy or sell the stocks, whereas the seller of the option must sell or buy the

---

55 *Id.*., p. 25.  
56 *Ibid.*.  
58 *Ibid.*.  
59 *Ibid.*.  
stocks, if the buyer chooses to exercise his or her option. Some scholars state that this practice is unacceptable because of the speculative activities attributed to it. Furthermore, Justice Mufti Muhammad Taqi Usmani also said that options are not permissible because the promisor (the obligated party) cannot charge the promisee (the buyer of the option) a fee (premium paid by the promisee) for making such a promise.\textsuperscript{61} However, scholars in favour of stock options state that, as opposed to futures, the underlying asset could be determined under stock options, thus making this kind of transaction more certain. Furthermore, the premium paid could also be seen as a contribution by the promisee to the promisor for his or her willingness to do business with the promisee, instead of viewing it as a fee imposed by the promisor. The premium is a mean of protection to the seller of the option from incurring unlimited losses.\textsuperscript{62} In Malaysia for example, the Muslim scholars do allow both put and call options associated with stocks that are halal in Islam.\textsuperscript{63}

9. \textit{Shari'ah Advisory Council of the Securities Commission}

In Malaysia, as mentioned above, the authority responsible for the determination of halal Stock is the \textit{Shari'ah} Advisory Body (SAB) of the Securities Commission (SC). The SAB was established on 1\textsuperscript{st} July 1996 and among the functions of SAB are:

9.1 To ensure the operation of Islamic capital market are in accordance with \textit{Shari'ah} principles;

9.2 To advice the Securities Commission regarding the development of Islamic capital market; and

9.3 To act as a reference centre in solving issues on Islamic capital market and \textit{Shari'ah}.

Some of the efforts that have been carried out by the SAB of SC are:

9.4 Increasing the unity of Islamic financial instrument and its services;

9.5 ‘Analysing the \textit{Shari’ah} status in KLSE shares;

9.6 Developing Islamic Securities benchmark; and

9.7 Developing Islamic Accounting Standard.

10. \textbf{Final Remarks}

As can be seen above, we believe that the SAB of SC are quite lenient in determining the approval of halal stocks. This can be proven by looking at the additional criteria outlined by them to evaluate companies that comprise of both halal and haram activities. It is undeniable that in modern age the practice of riba and bribery cannot be avoided (\textit{umum balwa}). However, in the case where a particular company involves itself

\textsuperscript{61} \textit{Id.}, p. 491.

\textsuperscript{62} Naughton, T. \textit{Supra}, ‘Is An Islamic Stock Market Viable?’, \textit{Anthology of Islamic Banking}, London: Institute of Islamic Banking and Insurance, p. 231.

\textsuperscript{63} Seen on 24\textsuperscript{th} of February, 2016: http://www.stockpoint.com
in *haram* activities with regard to gambling and liquor, we disagree with the present rulings outlined by the SAB. Our justifications here are based on several evidences:

10.1 Yusuf Al-Qaradawi said: “If something is entirely harmful it is *haram*, and if it is entirely beneficial it is *halal*.” He also said that, “Muslim jurists have established the criterion that whatever is conducive to or leads towards the *haram* is itself *haram*.∗∗ Furthermore, he stated that, “…anything which assists in the doing of what is *haram* is itself *haram*, and anyone who helps another person to do it shares in the sin of it.” This has actually been explained in the Qur’an. Allah says:

>“They ask thee concerning wine and gambling. Say: O Prophet(SAW), in them is great sin and some benefit for human being but the sin is greater than benefit.”

Therefore, it is seen that the sin of the *haram* is not limited to only the person who engages in it, but it extends to others who support it materially or morally; each participant is held accountable according to his or her share.

10.2 Hadith of the Prophet (SAW) mentioned:

>“The halal is clear and the haram is clear. Between the two, there are doubtful matters concerning which people do not know whether they are halal or haram. One who avoids them in order to safeguard his religion and his honour is safe, while if someone who engages in a part of them he may be doing something haram...Truly, every king has a hima (preserve), and the hima of Allah is what He has prohibited.”

Gambling and alcohol are proven to bring more harm than benefit to people and nations. When it comes to these two *haram* items, the indulgers are at loss, materially and morally. As a consequence, social problems like shattering of families and businesses, child abuse and theft occur. Hence, we suggest that stocks of companies involving in these two activities, be it significant or insignificant, should not be allowed to be purchased by Muslims.

Muslims cannot afford to ignore the capital market because the private sector, which holds a nation’s power are made up of entities that are naturally controlled by the shareholders, and ignoring the capital market implies ignoring the economic power of private sector and its attendant power of wealth creation, employment and training opportunities, control of economic knowledge and technology, and global economic relations.

---

65 *Id.*, p. 28.
66 *Id.*, p. 29.
As a result, attempts are made to develop Islamic capital markets to cater for the demands from local as well as foreign investors who seek to invest in securities based on Shari‘ah principles. The Kuala Lumpur Stock Exchange Shari‘ah Index (KLSE SI) and the Dow Jones Islamic Market Indexes are examples of such attempt. However, there remain issues on stock trading practices in which Islamic scholars are still not unanimous as to the validity of such practices. Examples are the contra and margin trading and options on stocks. Despite the ongoing debates, in Malaysia, the Islamic scholars do permit these practices, but with some modifications (for example replacing interest-based elements with Mudaraba principles) to meet the terms of Shari‘ah principles.

To submit here that, with the foreseeable future of globalisation, Muslims should take advantage of the potential benefits arising from the involvement in capital markets; this is to prevent the Muslims from being left behind the non-Muslims. However, it should be in the mind of the Muslim investors that whatever actions or activities they partake in the capital market, they must be in accordance with the guidelines and rules stated under the Shari‘ah principles.
The Islamic Worldview and Development Ideals

By
Junaid Qadir*

Abstract:
The concept of development and progress ultimately depends on the belief and value systems of the human population at large. In neoclassical economics, development is defined and measured narrowly in terms of economic growth only. This is in stark contrast with Islamic notions of human development. In the Islamic worldview, human life is purposeful, and human development can only be meaningfully measured in the backdrop of this purpose. The purpose of the article is to articulate the Islamic worldview and to then present the Islamic development ideals. We will also critically evaluate the modern secular notions of development by comparing and contrasting these with Islamic developmental ideals.

Key Words: Worldview, Human, Development, Notions, Economics, Ideals

1. Introduction
The concept of development and progress ultimately depends on the belief and value systems of the human population at large. In neoclassical economics, development has been defined in a very narrow way. Development is straight jacketed into a narrow sieve of economic growth: If a society is wealthy, we say that the country is developed; otherwise, we say that the society is undeveloped or underdeveloped (even if the society is composed of people who are literate, spiritual, humane and just). This goes against the Islamic perspective of development and progress. To understand the Islamic concept of development, we need to resort to the rich Islamic tradition while critically evaluating

---

* The Author is affiliated with Information Technology University, Punjab, Lahore, Pakistan. E-mail: (Junaid.qadir@itu.edu.pk)

the modern conception of development and accepting the new concepts that are consistent with the Islamic worldview.

Islamic life is purposeful and has some end goals. Current development metrics miss an all-important Islamic reality expressed in the Qur’an (51:56), “And I did not create the jinn and mankind except to worship me”. The traditional view of human development—a faith practiced by 1.6 billion Muslims worldwide (23% of the world’s population)—must be acknowledged for sustainable development needs as personal and societal commitment to the purpose envisioned. The purpose of the lives of humanity is clarified by God to be “nothing except for worship God” (Qur’an 51:56) and the end of human pursuit can be ascertained in the light of the Qur’anic verse “And that to your Lord is the finality” (Qur’an 53:42).

A. Myth of Progress and The Need For Authentic Definitions of Development

Societies are prone to taking wanton pride in their own way of living. Barack Obama described the American society in 2016 as the best ever saying, “If you had to choose any time in the course of human history to be alive, you’d choose this one. Right here in America, right now.” Qur’an indicates that many societies had similar mistaken views of the development of their own societies. The Pharaoh (Fir’awn) of Egypt who lived in the time of Prophet Musa also felt similarly for the civilization he was leading—referring to his civilization as “most exemplary” (Qur’an, 20:63). It’s important to state that Islam has its own unique view of what development is based on Weltanschauung—it is this view that we want to expound in this section.

Instead of the Eurocentric view that the Western liberal democratic system is the ultimate system that all societies will evolve towards, Islam—being a divine religion—considers the ideal society to be the one whose constitution is based on Godliness and spirituality. Islam prescribes a continuous renewal effort to maintain the societal values through the institution of Amr Bil M’arif Wa Nahi ‘Anil Munkar, through which the commanding of the fair and the prohibition of the undesired is performed at an individual and societal level. The society’s failure to perform this task leads to the loss of spirituality through a process of social entropy that erodes the fundamental values of the society and sometimes even flips it so that virtue become vice and vice versa. According to Islamic belief, the process of society’s spiritual renewal was typically entrusted to Prophets, but with the coming of the Prophet Muhammad(pbuh)—who is the last link in the chain of Prophets—the effort for the renewal of the society is now the duty of the Ummah. The Qur’an says (3:110), “You are the best of peoples, evolved for mankind, enjoining what is right, forbidding what is wrong and believing in God”.

Instead of believing in the myth of linear continuous progress that is propounded by thinkers who only think in material terms, Islam traditionally has believed in the need to have periodic renewals—failing which the society spirals down in an abyss of depravity.

---

2 Quotations from the Qur’an are given by citing the Chapter (Surah) and the verse (Āyah) numbers in parenthesis with an intervening colon. For example, verse 1 of Chapter 1 is called (1:1).

in which vices become virtues and vice versa. The Qurān uses the parable of rain that comes to bring life to the withering vegetation on Earth. The case of Prophets, and the righteous successors of the Prophet (pbuh) is similar since they serve to revive human spirituality, which may die even though the world may be progressing in material terms.

B. Seeing The Model Islamic Society Through The Lens of Development

We can demonstrate how the end of development as defined by Islam is starkly different from the modern definition by evaluating the Islamic model society comprising of the Ṣaḥabah (direct companions of the Prophet pbuh) who gave the form to the first (and most complete) Islamic society. If we take the narrow view of development in terms of material progress, this initial Islamic society would not be deemed highly developed—for the people of this society did not have much material wealth, they did not have modern technology, they were not universally literate, nor were the health facilities and the life expectancy commensurate to modern standards. This era however is described through established Islamic belief as the best and most-developed human civilization. If not for the wealth or the technology, what was it that elevated this generation to be “the best of generations”? The answer to this question would describe what are the development metrics as prescribed by Islam. It was the moral and spiritual wealth, rather than the material wealth of this pristine society—the development of the heart in terms of Īmān and Yaqīn (belief and certainty) through the sincere performance of actions while adhering to the Godly way personified through Sunnah (the way of the Prophet (pbuh)); the development of a human society based on equality, human brotherhood, and justice—that elevated that generation to be the best of the generations (as described in a Ḥadīth).

Just as it is instructive to see the positive example of development in the society of Ṣaḥabah molded by the Prophet (pbuh), it is also illuminating to see a negative example of what development is not according to Islam. The Qurān clarifies the real knowledge of development by narrating an example of Qarūn, an affluent contemporary of Moses (pbuh). The Qurān says (28:79–80), “So Qarūn came out before his people in his adornment; Those who desired the worldly life said, "Oh, would that we had like what was given to Qarūn; Indeed, he is one of great fortune. But those who had been given knowledge said, "Woe to you! The reward of Allah is better for he who believes and does righteousness; And none are granted it except the patient." Through this verse, God has clearly established that the belief in God and righteous actions constitutes real development and qualifies for better and everlasting reward.

When we start following human desires, we find that vices start to masquerade as virtue (as defined by God). For example, the modern concept of the virtue of liberty is abused to the extent that nothing is sacred and all morals judged on the basis of shifting relativist moral standards. This brings us to a situation where the ideals of humanism and of Islam can be antipodal. A society can only be considered developed from an Islamic point of view when it subscribes to the Islamic worldview around virtues and vices. In Islamic terminology, a society is said to suffer from Jāhiliyyah (ignorance) if the

---

4 According to a Hadith in Sahih Muslim, the Prophet was asked amongst the people were the best. He said: “(People) of my generation, then those next to them, then those next to them, then there would come a people whose evidence would precede their oath and their oath would precede their evidence”.

The Islamic Worldview and Development Ideals
traditional notions of virtue and vice are swapped—irrespective of how advanced the society may be in terms of technology or wealth. It is for this reason that the Roman and the Persian empires at the time of the Prophet (pbuh) were called Jāhiliyyah-inflicted societies, even though they were the superpowers of the time and well developed in terms of wealth.

2. Islamic Weltanschauung: Islam vs. Neoclassical Economics

“Principles of ethics or values are basically derived from worldviews. Therefore, every economic system, i.e., capitalism, socialism, and Islam, has a particular set of values which are unique to the system derived from its particular worldview. These ethical principles are implicitly incorporated in the notions, concepts, assumptions, ideals and even theories of economics.”—Seyyed Hossein Nasr.

Weltanschauung—German for worldview—is an important term that refers to how a community or culture conceptualizes reality and it is from this conception that normative principles of ethics, morals, and values emerge consciously or subconsciously. We find therefore that worldviews—e.g., the worldview of capitalism and socialism—can be antipodal insofar that even universal virtues—freedom, equality, and justice—are interpreted completely differently. 5 In this section, we will describe how the Islamic Weltanschauung is distinct from the modern worldviews engendered by neoclassical economics and neoliberal capitalism and thus views ‘development’ differently.

In contrast to the Islamic worldview, the dominant worldview today is a product of the era of the so-called “enlightenment” that has estranged God from human life and these days is based on neoclassical economics, neoliberal politics, scientism, and secular humanism. Modern sciences—including the physical, biological, psychological sciences—are grounded in the modern secular worldview. While the scientific method has brought tremendous achievement through advances in the physical sciences, the scientific conception of social sciences has had disastrous consequences over a period of times as these fields have become detached from ethics and normative values in a bid to become objective. Despite the claim to be value-free, these fields are anything but; the modern worldview deifies science and humanity—and this ideology pervades and informs all aspects of modern sciences (including economics). It is worth highlighting that Islam and sciences are not antipodal—Islam in fact encourages an empirical investigative approach in the Quran; Islam and the modern worldview differ in accepting God’s revelations and the role that God plays in human life.

In the remainder of this section, we will elaborate the Islamic worldview through the juxtaposition of Islamic ideals and the ideals of the modern secular worldview (characterized by neoclassical economics and neoliberal capitalism). After building up the context of this Islamic worldview and the associated Islamic value system, we will delve into the various aspects of Islamic development in the next section (i.e., Section 3).

---

A. Belief in Tawḥīd and Risālah and Man’s Amānah

“The birr does not consist in your turning your faces towards the East or the West, but [true birr] is this, that one believes in God, and the Last Day, and the Angels, and the Scripture, and the Prophets; that one gives one’s own wealth, howsoever cherished it may be, to kinsfolk, orphans, the needy, the wayfarer, and beggars, and also for the sake of [the liberation of] slaves; that one performs the ritual prayer, pays the alms. And those who keep their covenant when they have once covenanted and are patient in distress and hardship: these are they who are sincere; these are they who are God-fearing (muttaqūn).” (Qurān 2:177)

Imān or belief is the sine qua non of human development in the Islamic tradition. The passage above declares most emphatically that birr or “piety”—or even development, which is the subject of this paper—in the true sense does not only consist of ritualistic external practices of piety or material accumulation but on practical piety reflecting social righteousness that emerges naturally from Imān (a deep monotheistic faith in God). The passage above also brings out most emphatically that birr or “piety”—or even development, which is the subject of this paper—in the true sense does not only consist of observing outwardly the rules of some formalism, but also in the practical kind of “social righteousness” that naturally arises from a “deep monotheistic faith in God.”

The Islamic worldview is accepted by a human being who first affirms Tawḥīd, which refers to the fundamental belief of Islam about the oneness of God. The Latin terms `religio’ and `religare’ mean ‘to bind’ or to be linked to something; in a similar vein, Muslims bind themselves to follow the law of Fitrah, the ideal human state designed by God (Qurān 30:30), which is to be followed with due regard to the principle of Balance and Moderation (Qurān 55:7–8). Islam inculcates a sense of responsibility in human beings due to the Amānah (divine trust) that human beings undertook—which is that human beings in its primordial state accepted to do justice to the trust of being God’s vicegerent on Earth. This trust called Al-Amānah is described in the Qurān (33:72), “We did offer the Trust to the heavens and the earth and the mountains, but they refused to bear its burden and were afraid of it, and man picked it up.” (Qurān 33:72). Through this religious trust (Al-Amānah), human beings become bound to act ethically according to the dictates of the Divine Law. The religion of Islam is thus not premised on undertaking some mysterious dogmas but in the fulfillment of human potential in accordance with the demands of Fitrah (the ideal human nature) and Khilāfah (the status of vicegerency of God).

B. The Role of Ākhirah: Fundamental Problem of Humans is Ma`ād not Ma`ash

“And this worldly life is not but diversion and amusement. And indeed, the home of the Hereafter - that is the [eternal] life, if only they knew.” (Qurān 29:64)

The issue of Maʿād (returning to Allah), rather than Maʿāsh (Economics), is the most fundamental problem of Islam. The belief of Maʿād entails a concept of an afterlife (Al-Ākhirah) — an everlasting life that will follow the life in this world. This defines a fundamental and primary distinction between the Islamic and non-Islamic worldviews in that the former encompasses a concept of Al-Ākhirah. This worldly life (the focus of Maʿāsh) is considered a preceding interlude leading to the everlasting life—this worldly life (Al Dunyah) is nonetheless extremely important for the reason that it is what the man “earns” in this world in terms of actions and beliefs that dictates the state of the man in the everlasting afterlife. The belief of Maʿād is integrated comprehensively in all aspects of human life; as an example, Muslims reiterate the principle of Maʿād whenever faced with an adversity by reciting: “Inna lillahi wa inna ilahi rajion” (Qurān, 2:156), which can be translated as, “Verily we are from Allah and verily to Him shall we return”.

The belief of Maʿād is totally missing in contemporary economics—in which the economics goals are defined narrowly confined to an individual and only in material worldly terms (i.e., in terms that are not ultimately consequential in Islamic thought). The belief of Maʿād, far from being only a theoretical concept, has real consequences for human action for this belief can discourage myopic, greedy, self-centered behavior in which the entire end of human effort is personal gratification and amassing of wealth.

This is not to say that Islamic thought is inclined towards monasticism or only to other worldly asceticism. Muslims seek the good of both this world and the hereafter (Qurān, 2:201)—and seek to expend the goods of this world (be it wealth, power, government) in a responsible manner thereby fulfilling the rights of God and those due to God’s creation. In Islamic economics, earning sufficient wealth to support oneself and one’s dependents is an obligation. However, even in doing this, one is advised not to be totally immersed in this worldly life, but to always desire for the Hereafter. The Qurānic guidance is to “And seek the (betterment of) the Ultimate Abode with what Allah has given to you, and do not neglect your share from this world, and do good as Allah did good to you” (Qurān 28:77). A famous Hādhīth clarifies that the right approaches to the desires and the possessions of this worldly life should be to “Be in this worldly life as if you’re a stranger or a wayfarer” whose concerns are always rationally affixed on the destination rather than on the temporary traveling.

It is only the hereafter that ultimately has consequences for a Muslim since the smallest welfare of the hereafter is better and longer lasting than all the welfare of this world—as the Qurān says (19:76): "And the everlasting virtues are better with your Lord in respect of reward and better in their return.” (Qurān 19:76). Similarly, the difficulties of this world are inconsequential when compared to the difficulties of the hereafter, which are much graver in their magnitude. The Islamic tradition indicates that a man who only desires the world would be deprived of the hereafter, whereas one who covets the hereafter will be rewarded in both this world and the hereafter—as stated in the Qurān (42:20) that “Whoever desires the harvest of the Hereafter—We increase for him in his harvest. And whoever desired the harvest of this world (solely)—We give him thereof, but there is not for him in the Hereafter any share”.

---

C. **Islamic conception of knowledge and Islamic epistemology**

Islam greatly honors knowledge and the pursuit of knowledge. According to an Islamic understanding, not all types of knowledge are at the same level. The higher purpose for seeking knowledge in Islam is not simply logical and epistemological but ontological and existential—the goal being the purification of the soul and to know God (something that cannot simply be achieved through logic and argumentation). The highest knowledge in Islam is the knowledge of God, whose essence cannot be encompassed completely by limited human abilities, but whose qualities are known through revelation.

Islam allows empiricism and highly encourages it by repeatedly calling mankind to look at the various natural phenomena that act as signs of God. The Qurān says (10:6), “Lo! In the difference of day and night and all that Allah hath created in the heavens and the earth are signs, verily, for folk who ward of evil.” But the Islamic worldview describes that not all knowledge can be said to be at the same level. In particular, scientia—or human knowledge based on observation or rational thought—is regarded as legitimate in the Islamic worldview only if it is subordinated to sapientia—the Divine wisdom reflected in God’s revelation as codified in the Sharī‘ah.

The Islamic epistemology differs from modern scientistic epistemology that underpins the orthodox economic system, which is based on a secular humanistic epistemology that undeservingly elevates terrestrial man to be the ultimate arbitrator and judge of truth and all values. As a result, modern economics assumes that humans are the absolute masters of their selves and wealth, which they can exploit without any qualification or consideration—a concept that is antithetical to the Islamic worldview.

The Islamic epistemology departs from the modern secular (logical positivism based) epistemology based on many fronts: (1) Islam does not reject the unseen and commands for belief in the seen based on signs that can be recognized; (2) Islam proposes normative ideals and high moral standards—while logical positivism rejects morality as unscientific and meaningless; (3) Islam describes that there is a reality in the world that has both subjective and objective qualities in contrast to logical positivists who have in an mistaken search for objectivity stripped away reality from all subjective qualities. In a post-Kuhn view, and in view of various limitations, the opinion that science is value-free and completely objective is untenable and is increasingly being recognized by scientists. The foundation of Islamic epistemology on the other hand is revelation from God, which originates from the infallible and all-encompassing knowledge of God.

D. **Islamic Views on Human Dignity**

“(Remember) When your Lord said to the angels, I am going to create a vicegerent (Khalifah) deputy on the Earth” (Qurān 2:30)

---

Consistent with Judeo-Christian traditions, human beings in Islam are considered to be honored by God.\textsuperscript{13} The Qur\={a}n explicitly states (17:70) that, “We have certainly bestowed dignity on the children of Adam”. Furthermore, God has honored human beings by choosing humans to be God’s vicegerents on earth (Qur\={a}n, 2:30). Human beings are considered the best of God’s creation—surpassing even the angels in excellence—and to the fact that human beings have accepted God’s Trust (\textit{Al Aman\={a}h}) (Qur\={a}n, 33:72) of recognizing Him and worshiping Him alone freely on personal accord exercising the free will provided by God. By accepting this Trust, human beings becomes liable for an accounting in the Hereafter in which they will be rewarded for following the prescribed norms and punished for violating these (Qur\={a}n 2:38—39). Human beings are thus not like any other living being or animal on Earth, and they can fulfill their duties only after self-realization and self-recognition of who they are in essence and who their Lord is.

In some Islamic traditions in Islamic Sufism, development or moral advancement is considered as attaining \textit{al-takhalluq bi-akhl\={a}q All\={a}h}, which refers to acquiring a nominal similitude with the inimitable unique absolute character traits (\textit{Sif\={a}t}) of God—without human beings becoming the similitude (\textit{mithl}) of God in any anthropomorphic way. According to the Ibn ‘Arabi, the famous Islamic Sufi, humans are “\textit{Homo Image Dei}”—i.e., human beings are created in the image of God and given qualities derived from the eternal and absolute \textit{Sif\={a}at} of God. This is to be contrasted with the \textit{Homo Economicus} model of human beings adopted by economists in which the human beings are merely rational animals that seek to satisfy personal utility in a selfish manner. On the other extreme, modern secular humanists have elevated humanity itself to the level of divinity (\textit{Homo Deus})\textsuperscript{14} or have started to deify science\textsuperscript{15}. Such a worldview is antithetic to the Islamic worldview, to which this aberrance of deifying human beings and their civilization will be reminiscent of the ignorance (\textit{Jahilliyah}) of the earlier nations. For example, the Pharaoh (\textit{Fir\={a}wn}) at the time of Moses (pbuh) likewise claimed divinity (Qur\={a}n 79:24) and described his civilization and culture as exemplary (Qur\={a}n 20:63). According to the Islamic tradition, it is only by recognizing the dignity of man as the vicegerent and the servant of God can humanity attain self-realization and self-development and recognize its primordial pristine nature (\textit{Fi\={t}rah}).

\textbf{E. Islamic Views on Spiritual Nature of Man}

“The Divine really lies in the recesses of your self; search it. That is the only way open for your development.”
—Muhammad Iqbal, Bal-i-Jibril

“There is no doubt that, from the Islamic point of view, development has a spiritual character and cannot but mean the realization by men and women of all that they can become and all that they actually are here and now, even if many today remain unaware of their own nature considered in its totality and of all their God-given possibilities.”—Seyyed Hossein Nasr.

\begin{itemize}
\end{itemize}
As noted by the poet Muhammad Iqbal, the modern man is in a precarious position where he has ceased to live soulfully and resultantly he lives in open conflict with himself in the domain of thought and with others in the domain of economic and political life. Modern development theory revolves around material outcomes—which informs all its ideals and philosophies. The Islamic vision overturns this approach emphatically by stressing the primacy of the spiritual over the material world. Islam envisions human beings as creatures born for transcendence and views the end of their development to be the perfection of their spiritual possibilities. Islamic development ideals must therefore take this end into account, and it follows that any understanding of development that is devoid of spiritual development is flawed and cannot do anything but destroy the authentic Islamic conception of human development.

The Islamic concepts of 'heart' (qalb), spirit (ruḥ), and soul (nafs) may be defined as a "subtle tenuous substance, spiritual in nature, which is the perceiving and knowledge essence of man, and in reality is man". According to Islamic belief, the immaterial and immortal human soul is created directly by God, and is capable or recognizing God. The loss of spirituality arising from the failure to realize the self has had tragic consequences for human morality and ecological balance as various materialistic and secular ideologies have replaced the role placed by religion and spirituality. The invention of modernity has led to what Max Weber called the “disenchantment of the world”. Man has forgotten God and therefore God has made men forget himself—which is God’s way as elucidated in the Qurān (59:19), "And be not like those who forgot Allah, so He made them forget themselves”. The human pursuit of God realization only becomes possible through the realization of the spiritual human self and therefore takes precedence over all other knowledge—for in the words of Al-Ghazālı, “if a man knows not his soul, which is the nearest thing to him, what is the use of him claiming to know others?”

F. Islamic Views on Purposeful, Meaningful Nature of Life

"O wise men! it is good to have a thirst for knowledge,
But of what use is knowledge that cannot apprehend reality?"
—Muhammad Iqbal

The world today is beset with a nihilistic despairing belief that nothing in the world has any real purpose or existence. To fill the nihilistic void created in failing to believe in a deity and a creator, human beings have invented new religion-like ideologies such as humanism. The nihilistic religion is borne out of the creed of Darwinism and humanism, which promotes the worldview of previous misguided generations highlighted in the Qurān (45:24), “And they say, there is no life but our worldly life. We die and live, and nothing destroys us except time. They have no knowledge about that; they do nothing but make conjectures.” (Qurān 45:24). The entire edifice of morality in the humanistic religion is built on following ẓann (conjectures) and hawa

---

(personal caprice)—which leads to the problem of moral relativism and the direction of all human struggles towards material accumulation. The Qur’an says (45:23), “So, have you seen him who has taken his desires as his god, and Allah has let him go astray, despite having knowledge, and has sealed his ear and his heart, and put a cover on his eye? Now who will guide him after Allah? Still, do you not take lesson?”

Having short drifted the cosmos of any meaning, humanists draw from their own inner experiences meaning of their life and even the meaning of the entire universe. With the loss of religious spirituality and the forgetting of God, man—despite his material progress—is facing many crisis: there is the ecological crisis; there is the loss of meaning and purpose, the lack of a guiding overarching model of truth and ethics. The Qur’an disparages such relativist model of reality and describes such people as, “And they have thereof no knowledge. They follow not except assumption, and indeed, assumption availeth not against the truth at all.” (Qur’an 53:28)

The Islamic worldview unlike the dominant Western worldview does not perceive reality as devoid of the Divine. Islam highlights that life, just the creation of the Earth, is purposeful. The Qur’an says (23:115), “Then did you think that We created you uselessly and that to Us you would not be returned?” Development requires human beings to recognize Ḥaqq (the Truth) or to pursue Taḥqīq (Realization of the Truth)20. “We created not the heavens and the earth and all that is between them save with Ḥaqq (Truth),” (Qur’an 15:85). This Islamic ethical system based on revelation is also based on Ḥaqq, the Divine Truth. The Qur’anic system of morality exhorts people to follow the Divine Truth and not pursue personal caprice (Qur’an, 30:29)

G. Islamic Views on Wealth

“Fair in the eyes of men is the love of things they covet: Women and sons; Heaped-up hoards of gold and silver; horses branded (for blood and excellence); and (wealth of) cattle and well-tilled land. Such are the possessions of this world’s life; but in nearness to Allah is the best of the goals.” Qur’an 3:14

In contrast to conventional economics, wealth accumulation is not the alpha and omega of development of the individual or the society in the Islamic worldview. As put by Mufti Shafi (1978)21: “Economic progress is desirable for men, and the earning of a Halal livelihood is required after the religious requirements. At the same time, it is equally self evident that in Islam the fundamental problem of man is not economic, and economic progress is not a goal or objective of life for humans.” The Qur’an explicitly states that, “It is not your wealth or your children that will bring you near to Us — only in the case of people who have Imaan and act rightly; such people will have a double recompense for what they did. They will be safe from all harm in the High Halls of Paradise.” (Qur’an 34:37). Economic activity in Islam is a means to an end, and not an end in itself. This is also consistent with traditional Western thought for Aristotle is reported to have said, “Goods cannot have value since they are merely useful. It is human functioning that is of value”—it is only the recent perversion of traditional values through which the accumulation of wealth on its end has become the end goal of all economic activity.

The Islamic economic system is also in clear contradistinction with conventional economic systems in that it enforces moral and ethical guidelines on 1) how the money can be earned and 2) how it should be spent. The Qur’anic recommendation is never for amassing wealth; on the contrary, the Qur’anic leitmotif is Infāq Fi Sabīlillah (e.g., Qurān 2:274) through which spending in the path of God is stressed. The Holy Qurān (2:274) states that "Those who spend their possessions [for the sake of God] by night and by day, secretly and openly, shall have their reward with their Sustainer; and no fear need they have, and neither shall they grieve." It is stated in a Hadith that a man will be accountable before God for five things on the day of resurrection—two of which relate to economic matters: firstly, how did the person earn his wealth; and secondly, how did the person spend it. Thus far from a blind pursuit of more and more wealth, Islam encourages lawful (Halāl) earning and spending—i.e., the wealth should be earned through lawful and ethical business, and should be spent on lawful activities and on deserving causes (Qurān 59:7).

The spirit of Islam is at odds with the spirit of capitalism since it abhors hoarding of material goods (such as gold and silver) and proscribes mindless pursuit of wealth. Development is not the accumulation of wealth at the levels of individuals and at the level of society. The Qurān says (9:34), "They who hoard up gold and silver and spend it not in the way of Allah, unto them give tidings (O Muhammad) of a painful doom." It has been established in economic research that increased possession of wealth is a poor predictor of happiness after the basic needs are met due to the diminishing returns of wealth for subjective well being. There is in fact a great danger that the Sisyphean task of excessive pursuit of wealth will divert humanity from the real purpose of life (Qurān 102:1)—for human greed is unlimited and man’s needs multiply accordingly as man earns more wealth. Character strengths, on the other hand, have now been shown scientifically in the field of positive psychology to lead to happiness and wellbeing. Instead of encouraging its adherents to acquire wealth, Islam advocates spending on others so that the society benefits and there is no concentration of wealth. Islam tells us that the ideal amount of wealth is one that is just sufficient for our needs and explains that authentic richness is not in the abundance of goods but in the richness of the human soul. A Hadīth states, “Richness does not lie in the abundance of (worldly) goods, but richness is the richness of the soul (heart, self).”

To further deteriorate matters, the excessive pursuit of wealth has resulted in a graduate depletion of natural resources that has disturbed the ecological balance of the planet (irreversibly, as per an emerging consensus).

H. Islamic Principles of Moderation (Wasaṭiyah) and Balance (Mizān)

"Islam’s identification of itself as din al-fiṭrah is also indicative of an outlook of harmony with a God-ordained nature, people and the environment. Din al-fiṭrah implies that the earth is created in a state of natural equilibrium, endowed with the resources and capacity to sustain its life forms when not overwhelmed by corruption and excess, and when distributional equity is

observed. The Qur’an elevates and deepens the notion of aesthetic intelligence, bio-mimicry, and learning from nature. Science and technology must integrate the human factor and natural wisdom into a holistic outlook if they are to be conducive to sustainability.” —Seyyed Hossein Nasr

“Earth provides enough to satisfy every man’s need, but not any man’s greed.” —Gandhi

To discourage profligacy, Islamic develops a certain personality that is inclined away from undesirable traits (such as greed, self-centeredness, lack of compassion) and incorporates positive traits (such as compassion, magnanimity, moral courage, fear of God). The spirit of simplicity was pervasive in the earliest generation of Islam, which the Prophet (pbuh) referred to as the best generation. As an example, the Mosque of the Prophet (pbuh) that was erected in Madinah was described as, “The floor was sand and pebbles, the roof of palm branches, the pillars of palm trunks. When it rains, the floor becomes muddy. Stray dogs may be seen going in and out... This modest and simple building fostered the human angels, the tamers of giants, and the kings of the hereafter.”

The modern capitalistic culture makes many materialist assumptions such as nature constitutes a set of ‘resources’ that can be leveraged without reservations for human purposes, one can ‘own’ land, growth is always good and material consumptions leads to human satisfaction. It is true that some consumption is necessary for human life; however the malaise of extreme consumption is now rampanly supplanting traditional notions of virtue. In the words of Ali Shariati, "Beauty, truth, and charity—three most cherished, lasting values in human culture—were dismissed and in their place were installed the three popular principles of capitalism: realism, power, and consumption.”

The Qur’anic guideline is to use God-gifted resources with moderation (Waṣāṭiyah) and avoiding all wastefulness. Human beings must combine power over nature with responsibility for its protection and sustenance without causing abuse, exploitation, or oppression. The Qurān says (2:60), “Eat and drink from the provision of Allah, and do not commit abuse on the earth, spreading corruption.”

Neoclassical economics is fundamentally focused on allocating scarce resources among people who have unlimited wants (as emphasized in numerous popular textbooks). The fundamental problem of economics is not scarcity but entitlement—this is the reason that although we produce more food than needed, there are people who have

excessive food that goes to waste and there are others who starve to death. The scarcity assumption in neoclassical economics leads the industrialized nations to overproduce (which has been traumatic for the natural ecology); this is then followed by the use of advertisement to stoke up desires for unnecessary luxuries. This follows from the fact that modern neoclassical theory rejects the valid dichotomy of genuine human needs and extravagant human desires that can increase without limits. The Qur’anic approach to scarcity is different since it sets to create a human who can restrict idle desires and lead a simple life while at the same time spending on others who are less fortunate. Such a system is intrinsically more sustainable than the neoclassical economical system that has demonstrably caused havoc on natural ecological resources.

It is only the modern times in which greed, self-centeredness, and extravagance has become a virtue; the aim of all authentic religions always was always “to de-center the ego, not pander to its worldly desires”, as Huston Smith notes in his best-selling book “Why Religion Matters”. As a device for breaking the back of all worldly desires, the Prophet Muhammad (pbuh) recommended frequent remembrance of death—which the Prophet (pbuh) referred to as the destroyer of all worldly pleasures.

I. Islamic Emphasis on Social Justice and Equity

Justice is a fundamental demand of Islam. God is called the “the enforcer of justice” (Qāīm Bil Qisṭ) in the Qurān (3:8). God commands the believers to be the ones who stand for and enforce justice for His sake (Qurān 4:135). Furthermore, the rationale for sending prophets and the divine books is also stated in the Qurān (57:25) to be the enforcement of justice. Justice—it must be said—is a universal virtue considered praiseworthy in all the major economic systems (be it capitalism, socialism). However, each of these systems interprets justice accordingly to their worldview—e.g., capitalism delineates justice more in terms of individual interest while socialism defines justice in terms of society’s interest demoting individuals’ interest as subordinate. Islamic economic system takes a moderate approach and develops justice as the condition harmonizing individual and societal interests—in which all kinds of exploitation from the state or the individual is eliminated.

In his pioneering work on the rational wisdom of Sharʿīah, Shah Waliullah Dehlawi described how socio-economic rules dictate the level of civilization in a society (which the author refers to as Irtifāqāt). When an exploitative system is in vogue, the bottom strata of the society is forced to live much like animals and their efforts are restricted to fulfilling their biological needs, which restricts them from aiming for higher ideals. To obtain a just social order, the Islamic law holistically aims for the development of the individual and the society through the following fourfold

---


goals: i) the moral and the spiritual well-being of the moral agent as well as ii) that of others; and iii) the material well-being of the moral agent as well as iv) that of others. This is in stark contrast with conventional neoclassical economics that only focuses on one of these ends (i.e., on material well-being only of the self)—which makes conventional economics wholly unsuited to produce what Islam would call an ideally developed society.

Global justice also is important in the context of sustainable development since ironically the poor and those least guilty of pollution face the brunt of the capitalistic environmental excesses. The Quranic dictum of “la tazlimūna wa la tuzlamūn” (Qurān 2:279)—meaning you should not oppress and not be oppressed—should be implemented in form and spirit.

J. Islamic Emphasis on Transforming Societies

“You are the best group, evolved for the service of humanity, enjoining what is right, forbidding what is wrong...” (Qurān 3:110).

“The ultimate aim of the ego is not to see something, but to be something”

—Muhammad Iqbal.

Neoclassical economics assumes that human beings will act like Homo Economicus, an oversimplified mathematical model that defines self-interested utility maximization as rational behavior. Selfish greedy behavior thus becomes a normative ideal dimming the enormous potential of human beings. According to Islam, human beings have the potential to do good as well as evil: the Qurān highlights this dual potential of human beings saying (95: 4–5), "Surely We created man in the best of forms. Then We reduced him to the lowest of the low.” Just like human beings can be greedy, egocentric, and selfish, they also have the potential to attain the best of forms and to become a perfect human being (al-insān al-kamil). Islam assumes a different higher value-based normative model (called Homo Islamicus by some authors) setting higher ethical standards. Islam is concerned with the transformation of human beings from followers of base desires to people concerned with achieving higher goals. It was this transformation of human beings, brought about by the training of the Prophet Muhammad(pbuh) that revolutionized the world and changed the course of history.

Islamic economics is transformative since the aim of the Islamic development ideal is not to study the world but to change it positively. Islam stresses action over words—e.g., the Qurān states (9:105), “Do deeds! Allah will see your deeds, and (so will) His Messenger and the believers. And you will be brought back to the All-Knower of the unseen and the seen. Then He will inform you of what you used to do.” In fact, Islamic thought does not merely think that belief and righteous actions are sufficient for escaping loss—in addition, one must seek to transform the society by enjoining the truth, patience, and steadfastness through mutual exhortation. The Qurān says in Surah Al-‘Asr, “By


time. Indeed, mankind is in loss. Except for those who have believed and done righteous deeds and advised each other to truth and advised each other to patience."

As an example, justice and all other virtues are difficult to measure directly in a quantitative way. Furthermore, policy making in social systems that relies on quantitative analysis often turns counter productive due to the human propensity to adapt and game the system. This insight is popular in two alternate articulations: (1) Goodhart’s “Law” says that "when a measure becomes a target, it ceases to be a good measure"; and (2) Campbell’s “Law” states “The more any quantitative social indicator is used for social decision-making, the more subject it will be to corruption pressures”. The basic spirit of the Islamic approach is transformative and spiritual. Instead of focusing on measurement, the sense of justice and other virtues are instilled in the person’s heart, and once the heart of the person is transformed all the actions of the person will be sound. However, this must not be construed to imply that the normative inclinations of Islamic economics preclude the use of the scientific method—to the contrary, Islamic economics recognizes the scientific method as a tool par excellence when it is used in its proper place for the tasks that it is suited for.

3. The Ends of Development in Islam: Seven Overlapping Concepts

Development and progress can only be measured with reference to a set of values or objectives. Broadly speaking, the purpose of Shar'iah (Maqasid Al Shar'iah)\(^31\) is to ensure human good (Maṣlaha) and righteousness (ṣalāh) and to avoid harm (Dar'i al-mafāsid). In traditional formulation (e.g., in the works of Imam Al-Ghazālī d. 1111 CE), the objective of Islamic law is defined to be five-fold: (1) Religion (Dīn); (2) Life (Nafs); (3) Intellect (ʿAql); (4) Progeny or Family (Nasl); and (5) Property or Wealth (Māl). Thus Islam considers the development of people and their welfare in the safeguarding of their faith, their life, their intellect, their posterity and their wealth.\(^33\) Whatever ensures the safeguard of these five Maqaṣid serves public interest (Maṣlahah) and leads to development and progress. Whatever impedes these objectives is undesirable.

In the Islamic tradition, there exist many synonyms for the concept of development. The words Sa'adat, Fālah, Fauz refer roughly to happiness, felicity, prosperity, and success. We discuss some of these seven overlapping terms that relate to human development and progress in the following subsections.

A. Development as Purification (Tazkiyah)

“The value-system which the Holy Qur’an has given establishes spirituality as the root, morality as the trunk, and all other aspects of life: economic, political, etc., as off-shoots of morality; whereby it ensures the emergence of


\(^{32}\) Chapra, M.U., Khan, S. and Al Shaikh-Ali, A., 2008. The Islamic vision of development in the

the integrated and progressive individual and the integrated and progressive social order.”—Fazlur Rehman Ansari.

According to the Islamic tradition, Prophet Muhammad (pbuh) has introduced to the world the most refined system of spirituality known to humanity that leads to a thorough purification of the soul (Tazkiyat al-nafs, or simply Tazkiyah). The Qurān says, “As also We have sent in your midst a messenger from among you, who recites to you Our verses, and purifies you, and teaches you the Book and the wisdom, and teaches you what you did not know.” (Qurān 2:151). Tazkiyah is an expression that is derived and emphasized in the Qurān (91:7–9) and describes the effort through which (1) blameworthy character traits (akhlāq dhāmīmah) are eliminated; and (2) praiseworthy character traits (akhlāq ḥamīdah) are accumulated. It is through the efforts of Tazkiyah only can a human attain the pleasure of God, leading to falāh—prosperity in this world and the hereafter (Qurān 87:14; 91:9). The Qurān says (87:14), “He has certainly succeeded who purifies himself”.

Tazkiyah is the subject studied and elaborated in the Islamic sciences of Tasawwuf (Sufism) through which the state of Iḥsān or spiritual excellence is cultivated and the hearts of human beings are connected to the Transcendent God. Tazkiyah ultimately relates to the soundness of the heart (in which lies the human intention—and when the heart is sound, the actions (`amāl) that come forth from the body are ipso facto sound.34

The focus of Tazkiyah is not just the individual but it also seeks societal transformation.

Tazkiyah can be achieved through the following instruments (Khursid Ahmad)35: (1) dhikr—the remembrance of God; (2) `ibādah—servitude to God; (3) tawbah—repentance to God; (4) light of Maqasid al-Shariah (Vol. 15); IIIT. Auda J. Maqasid Al-Shariah A Beginner’s Guide. International Institute of Islamic Thought (IIIT); 2008; Kamali, M.H., 1999. “Maqasid Al-Shariah”: The objectives of Islamic Law. Islamic studies, 38(2), pp.193-208; Ashur, M.A.T.I., 2006. Ibn Ashur: Treatise on Maqasid Al-Shariah. IIIT.

Sabr—the spirit of perseverance and tolerance; (5) ḥasābah—criticism (including self-criticism); and (6) du`ā—supplication.

B. Development as Freedom (Uboodiyyah)

In the Islamic worldview, freedom is understood differently from its usual liberal interpretation. In Islamic conception, freedom is in escaping the slavehood of the creation (Makhliq) to arrive at the slavehood (`Ubūdiyah) of the creator (Khāliq). The free man is the one who’s the master of his desires (Nafs) while the slave is the one who’s a slave to his desires.

One can understand the nuanced meaning of freedom in Islam by recalling the story of the Rabia Ibn ‘Amir (a companion of the Prophet (pbuh) ) and the Persian army commander Rustom. In a famous historical duel, Rabia addressed Rustom in the following way, "Allah the Exalted has sent us to free and deliver you from worshipping the creation to worshipping the sustainer and creator (Rabb) of the creation. And to deliver you from the constriction of this world to the vastness of this world and the afterlife. And from the oppression of religions to the justice of Islam." (At-Tabari). This famous narration is important for two reasons. (1) It clearly articulates how different the Islamic conception of freedom is from modern notions of liberty and freedom as espoused by Rousseau et al. (i.e., Islamic conception of freedom is not in doing things that one desires to; freedom is in following divine injunctions and subjugating desires). (2) It also highlights the importance of the afterlife for Muslims, who believe that this world is transient and the afterlife is everlasting. The Islamic viewpoint of development must therefore necessarily reject any development conception that does not take into account the afterlife.

Furthermore, Islamic models of development must also be based fundamentally on Tawḥīd (Divine unity) and `Ubdīyah (servanthood) to God. Development is adherence to God's way and to follow the path of Divine Guidance (Al-huda) that God has revealed through His Prophet(pbuh) —in this way, Islamic economics can be defined in essence to be the "economics that is guided by the Prophet (pbuh) rather than by the Profit".

According to Al-Attas36, the Islamic concept of freedom is reflected in Ikhtiyār (i.e., choosing the better of all available actions). Muhammad Iqbal describes freedom as the "surrender to the moral ideals" and the ability of man to be free of lowly egocentric desires and to choose God. For Iqbal, liberty is not negative or positive liberty as argued by Isaiah Berlin37. Liberty or freedom is attained by discovering the laws of God in one’s self. This signifies the fusion of the will of God and that of man.

C. Development as the development of God-consciousness (Taqwā)

Taqwā literally means to guard oneself against Allah’s displeasure. God defines Taqwā as the measure of honor in Islam; the Qurān says (49:13), “Indeed the most noble of you in the Sight of Allah is the most righteous of you (Atqākum, which means the person with most Taqwā).”

Taqwā does not only bring about God’s pleasure in the hereafter. To the contrary, even worldly blessings come with Taqwā. God indicates how the blessings of the Earth and the Sky would have been opened to the people of the town if they had Taqwā, “And if the people of the towns had believed and had Taqwā (piety), certainly We would have opened for them blessings from the Heaven and the Earth; but they belied (the Messengers) so We took them (with punishment) for what they used to earn (unbelief and crimes)” (Qurān 7:96).

One of the important manifestations of *Taqwa* is to avoid the actions prohibited by God. Any society that flouts the Islamic boundaries of lawful and unlawful cannot be considered developed according to the Islamic viewpoint. In financial matters, this would mean prohibition of engaging in unethical business and avoiding interest. The prohibition of interest-based transactions in the *Qurān* comes in a uniquely stern manner in which God announces in a reprimanding way a war from Himself and His Messenger to those who don’t desist from this corrupting practice.

**D. Development as acquiring Excellence and Beauty (Ihsān)**

“And seek, through which Allah has given you, the home of the Hereafter; and [yet], do not forget your share of the world. And do Ihsān (be good) as Allah has done Ihsān towards you (has done good to you).” *(Quran 28:77)*

*Ihsān* is a comprehensive concept often translated by commentators and interpreters as excellence. *Al-Ihsān*, as Imam Raghib al-Isfahani (the famous Arabic linguist) explains, stands for “the creation of beauty in one’s conduct, which is achieved through beauty in knowledge and beauty in action”. The Prophet (p.b.u.h) clarified in a *Hadīth*, “God is beautiful and He loves beauty”. God is infinitely beautiful and the source of all beauty in the world and within us. Prophet Muhammad (p.b.u.h) also said: “Verily, Allah the Exalted loves that the doer of an action perfects his action.” In performing actions, once can attain *Ihsān* through the following: 1) Sincerity (*Ikhlās*); 2) Completeness; 3) Tastefulness (doing things in a nice manner); and 4) Correctness (doing things in the right way).

According to the Islamic philosopher Rafi-ud-din⁴⁸, the overriding ideal behind all the higher desires of man is the search for beauty. For example, moral action is the expression of beauty in one’s deeds. It is the man's desire for an ideal that dominates all his desires on the purely psychological level. The ideal is also the basis and source of the moral code of do’s and don’ts that a person follows. Broadly speaking, one can distinguish human desires into: (1) the lower desires, which can be referred to as animal instincts—such as feeding, sex, etc.—since these desires are common to man and the animals below him in the scale of evolution; (2) the higher desires, which refers to the desire of an ideal; the desire for moral action; the desire for knowledge; and the desire for artistic creation or art. These higher desires are specific to man and define a fundamental difference between human beings and other animals. These higher desires may be called the “free desires” since there is no biological compulsion attached to them and they belong exclusively to the psychological realm.

*Ihsān* can be thought of the development of higher consciousness through which human beings can transcend animal instincts and become conscious of a higher Self, a transcendental reality, or God. In Islamic belief, human development is achieved through the development of self-consciousness and more than that by God consciousness, which is the pinnacle of human development.

⁴⁸ Rafiuddin, Muhammad. The Ideology of the Future.
E. Development as Attaining Felicity or Happiness (Sa`ādat)

While happiness is a universal ideal that all humans across the various cultures aim for, the notions of happiness are culturally informed. Modern society has wrongly assumed that happiness is a byproduct of hedonism and consumerism. In conventional economics, human development is based on the ability of the economic man to fulfill material goals. The underlying assumption is that the more income a person achieves per capita, the more welfare (and consequently development) that is achieved. Spiritual achievement, ethical progress and conduct, God-consciousness is difficult to measure and is thus excluded from this calculation.

Islam stresses the attainment of everlasting and enduring happiness in the hereafter rather than the pursuit of the transient happiness of this world that is pursued by modern secularized cultures. It is the hereafter that will differentiate the happy from the wretched as the Qurān enunciates, “On the day it comes, no soul shall speak save by His Leave. Among them shall be the wretched and the felicitous (sa`ādat).” (11:105). The word Sa`ādat can loosely be defined as happiness and/or felicity. This world holds special significance in Islamic thought and has featured in the book titles of many leading scholars, such as Kimya Sa`ādat by Imam Al-Ghazali and Tahsilas Sa`ādat of Al-Farabi. Instead of the commonly used phrase “Pursuit of Happiness”, the Islamic comparable word means “Attainment of Happiness”, which is how Al-Farābi’s book’s title will be translated.

Paradoxically, it has been shown by researchers in the areas of positive psychology that increased wealth does not necessarily make a person happier and an agent has to aim at things other than one’s own happiness to become happy. Islam is clear in its stance that happiness does not lie in the hedonistic pursuit of wealth or pleasures; instead, it is the remembrance of God through which human beings find solace and happiness, as stated in the Qurān (13:28), "Verily, It is in the remembrance of Allah that Hearts Find Solace". The desire of only this world (Duniyah) is disparaged by God in the Qurān in the following way, “So turn away from whoever turns his back on Our message and desires not except the worldly life. That is their sum of knowledge. Indeed, your Lord is most knowing of who strays from His way, and He is most knowing of who is guided” (Qurān 53:29–30).

This is not to imply that Muslims have to make a choice between a good life in this world and the hereafter. To the contrary, those who act righteously and are believers will see eternal happiness in the hereafter and concomitantly a pure worldly life (Hayātan Ṭayyibah). The Qurān says (16:97), “Whoever does righteousness, whether male or female, while he is a believer - We will surely cause him to live a good life, and We will surely give them their reward [in the Hereafter] according to the best of what they used to do.”

F. Development as maintaining Akhlaq (High Morals):

“Religiosity without regard for the moral refinement and development emerges in the Qur’ānic view as nothing less than an opiate, because the very concept of ‘godliness’ loses all meaning without the active pursuit of the highest Morality.” —Fazl-Ur-Rahman Ansari\textsuperscript{42}

In the Hadīth, “I have only been sent to perfect noble character”, the Prophet (pbuh) described the mission of his Prophethood as Makārim ul Akhlāq, or perfection of practical morals. Laying the foundation for the perpetuation of this ethics-moral system was at the heart of the Prophet's (pbuh) mission. It is a fundamental ideal of an Islamic society that its members must have highly developed ethical disposition (Akhlāq). Akhlāq is the plural of Khuluq, which means the inner disposition of a human being. The Islamic ideal of Akhlāq—plural for khuluq, which refers to inner dispassion of a human being—is the character traits of the Prophet Muhammad (pbuh), whose exalted character was praised by God himself in the Qurān (68:4), “And You (Muhammad) are on an exalted standard of character”. According to Isutzu\textsuperscript{43} (the Japanese Qurānic scholar), ethics subsumes three kinds of moral discourse: (1) divine ethics—which relates to the divine attributes that relates to the ethical nature of God (e.g., ‘Merciful’, ‘Forgiving’, ‘Just’); (2) ethical human relationship with God, and (3) human social ethics towards fellow-humans that coexist in a society. These three ethical categories are not aloof or separate but integrate in multiple ways. It is by adhering to this Islamic ethical code of life that a person can return to the condition of genuine Fīṭrah (primordial ethical disposition) of man and it is only on the basis of this ethical system that any progress is possible in Islam.

Character in Islamic tradition is not confined only to external actions (such as cheerfulness, leadership, optimism, thankfulness, trustworthiness)—but more than that refers to the inner state of the heart or the soul that drives human actions. Imam Al-Ghazālī stated that man consists of two forms: 1) the khalq—which refers to the physical forms of human actions; and 2) khuluq (singular form of Akhlāq), which refers to the spiritual forms driving human actions. Thus true exalted character means elevated spiritual states based on the right intention and God-consciousness due to which outwardly ethical actions are driven. Broadly speaking, Islamic social ethics is guided by five general principles (The Study Qurān project\textsuperscript{44}, chapter by Dakake): (1) the significance of the Ummah (religious community); (2) the concern for justice; (3) the maintenance of social harmony; (4) human equality before God; and (5) the balancing of rights & responsibilities.


The Islam science of ethics (‘Ilm ul Akhlāq) is concerned with ways to develop virtuous praiseworthy qualities in human beings so that human beings become worthy of being the vicegerents of God on Earth. The two primary sources of Akhlāq are the Qurān and the Sunnah of the Prophet (pbbh). Moral life of a Muslim when applied correctly and honestly it results in a smoothly functioning of harmonious society, and at the same time it removes all barriers in the path of virtue. Alongside this, it endeavors to eradicate evils from social life by eliminating the causes of ills appearance and growth, by closing the inlets through which harms creeps into a society. All of the major societal functionalities—such as politics, economics, science, and law—can only function well if it incorporates ethics and is not detached from it.

A term fundamentally related to Akhlāq is Adab—which refers roughly speaking to comportment and wisdom. The idea of Adab is intrinsic to Islam and was philosophically developed comprehensively by Naquib Al-Attas.45 According to Al-Attas, a man of Adab is an individual who is fully conscious of his individual responsibility and has developed a proper relationship with himself, his Creator, his family members, his society—in effect with everyone who has a right on him. It is the loss of Adab that is causing human beings to transgress by excessive exploiting, hoarding, monopolizing the use of natural resources gifted by God; and by being egotistically driven to be insensitive to the needs of others—actions that belie the high position entrusted to humans by God on the account of being His vicegerents.

G. Development as maintaining ‘Umran (Civilization):

Islam is not only concerned with matters related to the hereafter. In contrast, Qurān clearly instructs the Muslims that even though the striving is for the hereafter (Al-Ākhira), one must not forget their share in this world. The concept of development is reflected in the Qurānic concept of Imar-Al-Ardh or building the earth (Qurān, 11:61), which is a duty of human beings as the vicegerent (Khālīfa) of God. The Qurān refers to īstīmar (civilizational construct) indicating that humanity is responsible for maintaining and building civilization on Earth (īmār al-ard).

The idea of building ‘Umran was taken up in rigorous manner by Ibn Khaldun (d. 1406 CE) who can lay a rightful claim to be the father of sociology as he developed a new insightful field of knowledge called īlm al-‘Umran or the science of ‘being together’—or sociology as it is called today. ‘Umran does entail constructing building (‘imara is a building or a construction) as well as establishing urban civilized societies. Ibn Khaldun’s idea of civilization (‘Umran)—a word related etymologically to Imar-Al-Ardh—refers to the building of humane civilization on earth, which entails transiting from a nomadic lifestyle to building of cities and attending to aesthetics and knowledge of both arts and sciences. ‘Umran is a polysemous concept that can mean ‘filling of a vacuum/void; culture; civilization; prosperity; and even development.

4. Conclusions

The concepts of development and progress are intricately tied with the value and belief systems of people that collectively define their worldview. The Islamic conception of development can only be understood in the context of the Islamic worldview, which stands in stark contrast with the modern secular worldview.

Islam is a monotheistic religion that preaches the unity of God (Tawḥīd). The Islamic worldview is distinct from the modern worldview because of its distinct epistemology and the eschatological belief of an afterlife—which transforms the goals of human efforts from worldly accumulation of wealth to preparation for the return to God (Maʿād). Islam believes that human beings are the best of God’s creation, and God has chosen human beings as His vicegerents on earth. The dignity of human beings arises from their spiritual nature, and human beings can attain excellence by developing their spiritual nature. Islamic worldview tells us that human beings have been created with the purpose of worshipping God and acting as responsible trustees of the God’s trust. In this regard, Islam offers specific guidance on how to acquire wealth and consume resources in a balanced moderate manner. Islam makes human beings responsible for establishing an ideal just society through the imperative of establishing justice on earth for the sake of God.

The Islamic conception of development is spiritual and is built through slavehood of God (ʿUbūdiyyah), the development of God consciousness (Taqwa), and the purification of the soul (Tazkiyah). Through purification, and the inculcation of the desirable spiritual virtues and the elimination of undesirable spiritual vices, human beings can attain an excellent disposition in all matters (Ihsān)—especially in terms of the ethical and moral characteristics of a person (Akhlāq). In the Islamic tradition, a lofty civilization (Umran) is built by producing human beings who have these qualities—and these are the qualities through which human beings can live a goodly life (Hayāt Tayyibah) and also ultimate felicity and happiness (Saʿādah) in the hereafter.
Exploring the Significance of Islamic Environmental Ethics for Fostering Sustainable Environment

By
Dr. Salman Ahmed Shaikh*

Abstract

The last five human generations have pushed planetary boundaries through the unprecedented burning of fossil fuels, rapid deforestation, contamination of seas and which has caused arise in temperature, frequent heat waves, floods, melting of glaciers and enormous loss of marine and tropical forest species. In this paper, we discuss the implications of Islamic worldview and environmental ethics in creating more commitment and environment friendly sustainable co-existence with nature. We discuss that the theistic concepts of Tawheed, Khilafah and Akhirah govern the Islamic way of life. Belief in a single source of creation defies racial, ethnic or gender basis of biases. Simultaneously, the concept of Khilafah raises the stature of human beings as moral beings with an inbuilt and active conscience, which provides the ability to differentiate moral from immoral acts. It inculcates the responsibility of custodianship, trusteeship and stewardship in human beings with regards to the use and ownership of physical property and environmental resources. While the concept of Tawheed creates an equal basis for humans to use what is bestowed in nature, the concept of Khilafahinstils stewardship towards the responsible use of natural and environmental resources without pushing planetary boundaries and causing precious loss of biodiversity. However, when we assess OIC countries on upholding these ideals, we find a mixed picture. In total carbon emissions, OIC countries perform comparatively better. But, in a broader spectrum of environmental performance, OIC member countries perform less well.

* Author: Dr. Salman Ahmed Shaikh, Assistant Professor of Management Sciences, SZABIST, Karachi. E-mail: salmanahmed_hyd@hotmail.com
1. Introduction

Some three centuries after the onset of the Industrial revolution, we have achieved phenomenal economic growth. Gross World Product has risen from a mere $100 billion in 1700 to $78 trillion in 2014. During the 20th century, world population increased by a factor of 4, whereas industrial output grew by a factor of 40. However, the intensity with which environmental resources are used increased sharply. The last two generations in the 20th century alone brought an increase in energy consumption by a factor of 16. Fish harvesting increased by a multiple of 35 and carbon and sulphur emissions grew 10 times (Dasgupta, 2010). The last five human generations have pushed planetary boundaries through the unprecedented burning of fossil fuels, rapid deforestation, contamination of seas and which has caused arise in temperature, frequent heat waves, floods, melting of glaciers and enormous loss of marine and tropical forest species. It is estimated that continued use of fossil energy will lead to an increase of the average global temperature by 1.0–3.5 degree Celsius in the coming 50–100 years. (Dagobert, 2000). Cook et al. (2013) reveal that 97.1% of scientists endorsed the consensus position that humans are causing global warming. The recently concluded COP21 conference in Paris in 2015 on climate change put forward an agreement to reduce greenhouse emissions and control global warming, however, the agreement will become legally binding if joined by at least 55 countries which together represent at least 55% of global greenhouse emissions.

In addition to the above anthropogenic disruptions, the global sea levels have risen by about 8 inches since 1870, according to World Research Institute. Ironically, we have a garbage island of the size of India, Europe and Mexico combined floating in our oceans. On the other hand, we also waste almost half of the food that we produce (Lundqvist, 2008).

Thus, the enormous economic growth we have achieved has come at a significant cost to the environment and life supporting systems on the planet (Maidin, 2011). Even the benefits of the economic growth have not been shared equitably among the last five human generations. According to Oxfam, the 62 richest billionaires own as much wealth as the poorer half of the world’s population. In contrast, one in every four people in Africa goes to bed hungry every night, according to Food and Agriculture Organization. Hunger kills more people each year than AIDS, malaria and tuberculosis combined. Do we really have a scarcity of resources due to which we cannot end poverty, hunger and famine? Nobel Laureate, Sen (1983) did research on famine in Bengal and he argued that the famine was not caused by the lack of resources. Strikingly, world agriculture produces 17% more calories per person today than it did 30 years ago, despite a 70% increase in the population (Pingali, 2002).

Deep within, this state of affairs represents an enormous moral crisis (Gada, 2014). The rapid deterioration of human environment is nothing but a crisis of values (Jusoff & Samah, 2011). This position is not a default outcome of random interactions of matter. We
have reached to this point through a result of conscious human actions, even if they represent a minority of human beings. The views about life affect our preferences and choices. Thus, the sustainable existence of life and life supporting systems hinges upon a social contract and worldview which can inculcate the notion of responsibility, humility, contentment and commitment in place of the self-centric pursuit of instinctive pleasures with envy and carelessness in our minds.

Even if the fiat money is printed excessively, it cannot substitute and exchange nature beyond capacity. Costanza et al. (1998) estimate that the minimum annual average value of ecosystem services is 1.8 times the global GNP. Hence, the replacement cost is more than the economic output that we produce annually. On the other hand, many ecosystem services are literally irreplaceable. Ansary (2010) warns that nature is irreducible to its purely quantitative aspect, just as a book is irreducible to its weight or dimensions. Khalid (2002, pp. 332) explains the effects of growth led by fiat money expansion as follows:

“*These tokens of value that we create from nothing and use everyday grow exponentially ad infinitum. But we know that the natural world, which is subject to drastic resource depletion, has limits and is finite. This equation is lopsided.*”

Hassan (2006) explains that instead of preservation and restraint, we are borrowing from the future to consume now via the credit card culture. In a word, we are jeopardizing the future of our children let alone leaving them in at least the same position as ours. ASTRÖM (2011) explains that one of the problematic points of view of today’s generation is that they have the rights of limitless ownership without taking into account the responsibilities towards society and humanity.

In this paper, we discuss the implications of Islamic worldview and environmental ethics in creating more commitment and environment friendly sustainable co-existence. We explain the philosophy of life in Islamic worldview in Section 2. We analyse the salient socio-economic implications of Islamic worldview on consumption and production choices and dealing with negative externalities. In Section 3, we present and elaborate how the environmental related Sustainable Development Goals (SDGs) are in harmony with the Islamic environmental ethics. The divine and spiritual significance of Islamic environmental ethics can play an effective role of a catalyst force for increased commitment and responsible behaviour in Muslim population which comprise a quarter of the global population and who find themselves in the midst of critical environmental related problems. In Section 4, we analyse the comparative performance of OIC and non-OIC member countries on environmental indicators, such as carbon emissions, use of renewable energy, wastewater treatment, air quality, water resources, sanitation, climate, bio diversity and environmental health impacts.

2. Philosophy of Life in Islamic Worldview & Its Socio-Economic Implications

The theistic concepts of *Tawheed, Khilafah* and *Akhirah* govern the Islamic way of life. Belief in the single source of creation defies racial, ethnic or gender basis of biases.
According to Islam, all creations belong to Allah. Animals and plants are partners to man in the universe (Mian et al., 2013). Simultaneously, the concept of *Khilafah* raises the stature of human beings as moral beings with an inbuilt and active conscience, which provides the ability to differentiate moral from immoral acts. It inculcates the responsibility of custodianship, trusteeship and stewardship in human beings with regards to the use and ownership of physical property and environmental resources. The two worldly view of life in Islam extends the decision horizon of economic agents, be they firms or consumers.

While the concept of *Tawheed* creates an equal basis for humans to use what is bestowed in nature, the concept of *Khilafah* instils stewardship towards the responsible use of natural and environmental resources without pushing planetary boundaries and causing precious loss of biodiversity. Hope & Jones (2014) investigated the link between faith and attitudes to environmental issues. As per the findings, the Muslim participants argued that the continued burning of fossil fuels would be immoral because they could disrupt the balance of nature, leave a dubious inheritance for future generations, and would constitute poor stewardship of Allah’s creation, for which they would be judged.

According to World Values Survey sixth wave (2010-2014), 29% respondents in 21 OIC member countries state that ‘looking after the environment and to care for nature and save life resources’ best describes their view and attitude towards the environment as compared to 21% stating the same in 39 non-Muslim majority countries. Ansary (2010) also gives an account of how religious motives in practice prove to be strong motivators for environment friendly actions like conservation and tree plantation than the laws of the land.

Environmental stewardship requires that we use natural resources ethically so as to equally improve the welfare of society, other living organisms, and future generations (Alghamdi, 2014). The relationship between human and nature is one of custodianship or guardianship, and not of dominance (Islam, M. N. & Islam, M. S., 2015). The earth’s resources are available for humanity’s use, but these gifts come from God with certain ethical restraints. We may use the resources to meet our needs, but only in a way that does not upset ecological balance and that does not compromise the ability of future generations to meet their needs (Riham, 2014). These principles lead Kula (2014) to conclude that Islam is an environment friendly religion.

The Islamic moral injunctions influence preferences through moral filtering of the consumption set by identifying the moral ‘BADS’. The moral philosophy imbued with socio-ethical spirit extends the decision horizon of consumers. It encourages the transformation of self-centric self interest into self-cum-social centric self interest. The moral injunctions explicitly extol virtuous philanthropy. Finally, by flattening all other basis of distinction except on piety, Islamic values garner contentment whereby, the consumer is asked to shun envious and conspicuous consumption of luxuries.

Islamic philosophy of life prioritizes equitable distribution over Pareto efficiency. Overreliance on Pareto efficiency paralyses the equity and ethical concerns of development policy change. As per Pareto efficiency, it is inefficient to help millions of poor to make them better off while making any single rich person worse off. While Islamic principles allow freedom and liberty in lawful consumption within the moral
boundaries, they induce affirmative action to promote wellbeing when people possess the means. In contrast, according to consumer sovereignty, as long as people can put up dollar votes for their preferences, resources will be allocated on producing, marketing and distributing inessential goods even if a quarter of world population lives in poverty and suffer from hunger, malnourishment and curable diseases.

Rather than complimenting humans in their animalistic instincts to keep having a one-eyed focus on material well-being only, Islam inculcates piousness, kindness, cooperation and communal responsibility in humans. In some instances, Islam guides explicitly to avoid extravagance, lavishness and using certain products and services which harm a human’s ethical existence and well being either individually and/or harm the society in the process. Islamic economics incorporates ethical values and excludes from the consumption bundle various goods which bring either private loss or welfare loss to the society.

Islamic philosophy of life brings a long term perspective to the pursuit of self-interest by informing humans about the positive and negative consequences of their actions and choices in the life hereafter. In the secular worldview, due to the absence of afterlife accountability, the rich people with absolute and inviolable property rights can command natural and environmental resources whose potential lifespan is much more than the lives of their owners. But, if the rich people believe in no afterlife accountability, they can extract and exploit these resources quickly and deprive future generations of their use.

Extinction of species, global warming, climate change, depletion of ozone layer and massive carbon emissions are inevitable results of the secular and individualistic paradigm. Climate change is a slow, but a cumulative process. Individual human lifespan is only an infinitesimally small fraction of the life of environmental resources and ecosystem services. Hence, the self-centric and this worldly view of life are incompatible with the concerns of sustainability and socially responsible behaviour. Rather, the dogmatic commitment to self-centric secular worldview results in inevitable proliferation of pollution as a right and product to be bought and sold in the market economy. It is ironic, but inevitable to see measures such as ‘value of statistical life’. On the action and policy front in capitalistic democracies, voter ignorance as well as the public-good nature of any results of political activity tends to create a situation in which maximizing an individual’s private surplus through rent seeking can be at the expense of a lower economic surplus for all consumers and producers.

Mortazvi (2004) contends that Western economics has become a discipline devoid of values. Exploitation of the natural environment can be abated when individuals consider intergenerational welfare and justice to be important factors in their economic decisions. Na’iya (2007) suggests that the effective solution to the environmental problems lies on the overall worldview which spells out the relationship between man, nature and his Creator as well as the implications of one’s actions in the hereafter. Religion provides such meaningful conditioning which enables bringing the right balance between human aspirations and the physical limits of nature. Religion also promises salvage from the limitedness of this worldly life in heaven which will be awarded to the
most righteous people. This, in turn, provides a permanent incentive to choose righteous
behaviour as an end with the hope and fear of deterministic results in the life hereafter.

3. Islamic Principles & Environment Related SDGs

The Sustainable Development Goals (SDGs) as successor to Millennium
Development Goals (MDGs) represent a broader intergovernmental agreement to foster
action on broad based development encompassing economic development, human
development and environmental sustainability. There are at least six out of 17 goals
which are closely related to the environment. The goal 6 on water and sanitation aims to
ensure availability and sustainable management of water and sanitation for all. The goal 7
on energy aspires to ensure access to affordable, reliable, sustainable and modern energy
for all. Goal 12 on consumption targets sustainable consumption and production patterns.
Goal 13 on climate urges action to combat climate change and its impacts. Goal 14 on
marine-ecosystems emphasizes conservation and sustainable use of the oceans, seas and
marine resources for sustainable development. Finally, the goal 15 on ecosystems vows
to restore and promote sustainable use of terrestrial ecosystems, sustainable management
of forests, combating desertification and check land degradation and biodiversity loss.

In this section, we look at how Islamic environmental ethics encapsulated in
Islamic principles compliment these SDGs and can act as a catalyst to foster
commitment, responsibility and affirmative action for sustainable and congenial co-
existence with the environment. With the concept of afterlife accountability, Islam
immensely influences intertemporal choice and behaviour. It helps in private economic
agents (consumers and producers) to modify their actions in such a way that takes
externalities into consideration and also their own welfare, both in this world and
afterwards.

The discussion of ‘protection of progeny’ as Maqasid-e-Shari’ah by Imam Ghazali
shows the ethical commitment to sustainable existence in an Islamic paradigm much well
before the reactionary focus in West about sustainable development. Below, we mention
several verses from Quran and sayings of Prophet Muhammad (peace be upon Him)
which discuss the responsibilities to the environment.

It is pertinent that humans incorporate social cost in their private actions for
achieving environment related SDGs. If we want clean air, fresh water and proper
sanitation for ourselves, then we must also like these things for others living in the
present age as well as those who are to come in this world in the next generations.
Prophet Muhammad (peace be upon Him) said:

“A Muslim is the one who avoids harming Muslims with his tongue and hands.”
(Source: Sahih al-Bukhari, Vol 1, Book 2, Hadith No. 9)

The realization of the enormous value of nature and environment even if it is in no
one’s private ownership is vital for fostering a culture of caring and responsibility
towards the environment. Quran refers to nature as ‘Ayat’ (signs). The book of nature is
also a revealed scripture, each page of which reveals a truth (Ansary, 2010). Affirmative
actions towards preserving and conserving environment are needed as a culture for
achieving environmental sustainability. Islamic philosophy of life provides the necessary
impetus and deterministic rewards for affirmative action towards promoting positive externalities in the environment. Prophet Muhammad (peace be upon Him) said:

“There is none amongst the Muslims who plants a tree or sows seeds, and then a bird, or a person or an animal eats from it, but is regarded as a charitable gift for him.”

(Source: Sahih Al-Bukhari, Vol 3, Book 39, Hadith No. 513)

In another Hadith, Prophet Muhammad (peace be upon Him) said:

“Whoever plants trees, God will give him reward to the extent of their fruit.”

(Source: Musnad, Vol 5, Hadith No. 415)

Climate change and environmental degradation are a slow and cumulative process. To resurrect environment, the efforts also need to be cumulative and consistent. A self-centric secular worldview encourages the self-centric use of private property resources. However, even small things done collectively and consistently can have a compounding effect. The two-worldly view of life in Islam encourages socially responsible behaviour as one of the prime determinants of salvage in the life hereafter. Prophet Muhammad (peace be upon Him) said:

“If the Resurrection were established upon one of you while he has in his hand a sapling, then let him plant it.”

(Source: Musnad Ahmad, Hadith No. 12491)

Quran informs that other species also praise and thank the Creator for the blessings. Quran says: “Do you not see that to Allah bow down in worship all things that are in the heavens and on earth- the sun, the moon, the stars; the hills, the trees, the animals; and a great number among mankind?” (Chapter 22, Verse 18). The single source of creation as encapsulated in the concept of Tawheed undermines the tendency to feel ‘fittest survivors’. It brings humility, congeniality and peaceful co-existence with other life in the environment. Prophet Muhammad (peace be upon Him) said:

“A good deed done to a beast is as good as doing good to a human being; while an act of cruelty to a beast is as bad as an act of cruelty to human beings”, and that: “Kindness to animals was promised rewards in the life hereafter.”

(Source: Mishkat al-Masabih; Book 6; Chapter 7, 8:178)

In another narrative, the Prophet (pbuh) was asked whether acts of charity even to the animals were rewarded by Allah or not. He replied: ‘yes, there is a reward for acts of charity to every beast alive.’

(Source: Sahih Muslim, Book 26; Hadith No. 5577)

Islam, M. N. & Islam, M. S. (2015) explicate that killing animals for fun or mere sport is strictly disallowed in Islam. In order to protect land, forests and wildlife, the Prophet Muhammad (peace be upon Him) created inviolable zones known as hima and
haram, in which resources were to be left untouched. Hima applies particularly to wildlife and forestry and usually designates an area of land where grazing and woodcutting are restricted, or where certain animal species are protected.

As mentioned earlier, almost half of the produced food goes wasted while on the other hand, one out of every nine people in the world suffers from hunger, according to Food and Agriculture Organization. Islamic principles discourage conspicuous consumption on luxuries. The Quran says:

“But waste not by excess: for Allah loveth not the wasters.”

(Source: Holy Quran, Chapter 6: Verse 141)

When the Prophet Muhammad (peace be upon Him) saw Sa’d performing wudu, He (peace be upon Him) said: “What is this? You are wasting water.” Sa’d replied: “Can there be wastefulness while performing ablution?” The Prophet Muhammad (peace be upon Him) replied: “Yes even if you perform it in a flowing river.”

(Source: Ibn-e-Maja, VI, Hadith No. 425)

Even with finite resources, we can still do much better in reducing hunger, malnourishment, child mortality and deaths from easily curable diseases. This requires a transformation of self-centric self interest view of life into self-cum social centric one. Prophet Muhammad (peace be upon Him) said:

“Among the three types of people with whom God, on the Day of Resurrection, will neither exchange neither words, nor look at is the one who possesses an excess of water but withholds it from others. God will say to him: ‘Today, I shall withhold from you my grace as you withheld from others, the excess of what you had, but which you did not create.’ ”

(Source: Sahih Al-Bukhari, Vol 3, Book 40, Hadith No. 557)

Thus, we see that Islamic environmental ethics can play the role of a catalyst to increase commitment, encourage affirmative action and responsible co-existence with the environment. In the next section, we analyse the progress towards upholding these ideals in reality in OIC and non-OIC countries.

4. **Comparison of OIC vs. Non-OIC Countries on Environmental Indicators**

There are 57 member states in the Organization of Islamic Cooperation (OIC) including 27 from Africa, 26 from Asia and 2 each from Europe and South America. Some of the oil-rich Muslim countries have per capita income comparable to developed countries. On the other hand, some of the member states from Africa have one of the lowest per capita incomes. While Qatar has an envious per capita income in excess of $93,000, Somalia has a per capita income of $133 only. At least 7 OIC member states have per capita income below $650.
In this section, we look at the comparison of OIC and non-OIC countries on environmental indicators. According to World Research Institute 2012 data on total carbon emissions, 17 of the top 50 and 18 of the bottom 50 countries are OIC member countries. But, the top 10 carbon emitting countries include only one OIC member country (Iran). Top 5 countries on the list include China, United States, India, Russia and Japan. On the other hand, the share of top 5 countries in the total global carbon emissions is 60.2%. The share of 56 OIC member countries in total global carbon emissions is 12.77% while their share in total global population is 23%. Conversely, the share of 125 non-OIC member countries in total global carbon emissions is 87.23% while their share in total global population is 77%.

In 101 countries out of the total 181 countries for which data is available, the share in total global carbon emissions is lesser than the share in the total global population. Strikingly, 40 of these 101 countries are OIC member countries. Looking at it from another perspective, 40 out of 56 countries have a lesser share in total global carbon emissions as compared to their share in the total global population. Conversely, 80 countries where the share in total global carbon emissions is greater than the share in the total global population, only 16 are OIC member countries and 64 are non-OIC member countries.

Top 5 countries with the highest positive difference between share in total global carbon emissions and share in total global population include United States, China, Russia, Japan and Germany. The United States has the highest difference at 11.34% with a share in total global carbon emissions recorded at 15.84% and share in global population standing at 4.50%. Interestingly, none of the OIC member countries features in the top 5 countries list with the highest positive difference between share in total global carbon emissions and share in total global population.

Next, we look at the comparative performance of countries in using renewable energy to produce electricity. World Bank’s 2012 data on ‘Sustainable Energy for All’ shows that 6 of the top 20 as well as bottom 20 countries are OIC Member Countries. However, high income OIC members such as United Arab Emirates and Qatar do not produce electricity from renewable sources at all. On the other hand, 6 of the OIC countries in the top 20 highest electricity producers from renewable sources include mostly low to middle income countries. While two of these countries feature from Africa (Togo and Mozambique), none feature from oil rich Middle East OIC countries. This shows complacency which can create hurdles going forward as the oil and gas resources near exhaustion.

However, if we compare the overall environment performance of OIC and non-OIC countries, we find less impressive performance of OIC countries. Table 1 gives few contrasting results summary of the Environmental Performance Index (EPI) 2014 for 56 OIC and 123 non-OIC member countries for which statistics are available.
Table 1: Comparison of OIC & Non-OIC Countries on Environmental Indicators

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Top 50</th>
<th>Bottom 50</th>
<th>OIC Average</th>
<th>Non-OIC Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Environment Performance Index</td>
<td>6</td>
<td>26</td>
<td>42.37</td>
<td>54.50</td>
</tr>
<tr>
<td>Environmental Health</td>
<td>7</td>
<td>23</td>
<td>55.86</td>
<td>69.53</td>
</tr>
<tr>
<td>Ecosystem Vitality</td>
<td>6</td>
<td>23</td>
<td>33.22</td>
<td>44.37</td>
</tr>
<tr>
<td>Selected Individual Indicators</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wastewater Treatment</td>
<td>9</td>
<td>22</td>
<td>14.54</td>
<td>29.37</td>
</tr>
<tr>
<td>Drinking Water</td>
<td>9</td>
<td>25</td>
<td>41.00</td>
<td>61.02</td>
</tr>
<tr>
<td>Sanitation</td>
<td>11</td>
<td>23</td>
<td>36.39</td>
<td>48.33</td>
</tr>
<tr>
<td>Air Pollution</td>
<td>11</td>
<td>16</td>
<td>80.28</td>
<td>82.38</td>
</tr>
<tr>
<td>Household Air Quality</td>
<td>15</td>
<td>22</td>
<td>58.75</td>
<td>68.62</td>
</tr>
<tr>
<td>Climate &amp; Energy</td>
<td>9</td>
<td>14</td>
<td>47.49</td>
<td>48.83</td>
</tr>
<tr>
<td>Biodiversity &amp; Habitat</td>
<td>11</td>
<td>28</td>
<td>42.72</td>
<td>63.34</td>
</tr>
<tr>
<td>Water Resources</td>
<td>9</td>
<td>22</td>
<td>12.78</td>
<td>30.28</td>
</tr>
<tr>
<td>Environmental Health Impacts</td>
<td>8</td>
<td>26</td>
<td>52.21</td>
<td>73.08</td>
</tr>
</tbody>
</table>

Source: Environmental Performance Index 2014

Environmental Performance Index (EPI) was developed by Yale University (Yale Center for Environmental Law and Policy) and Columbia University (Center for International Earth Science Information Network) in collaboration with the World Economic Forum and the Joint Research Centre of the European Commission. The index includes several indicators under the category of environmental health (EH) and ecosystem vitality (EV), such as: Environmental Health Impacts, Air Quality, Water and Sanitation, Forests, Fisheries, Biodiversity & Habitat and Climate & Energy.

The average score on EPI for 56 OIC countries stands at 42.37 while the average score on EPI for 123 non-OIC countries stands at 54.50. Likewise, the average score on environmental health sub-index for 56 OIC countries stands at 55.86 while the average score on environmental health sub-index for 123 non-OIC countries stands at 69.53. Finally, the average score on ecosystem vitality sub-index for 56 OIC countries stands at 33.22 while the average score on ecosystem vitality sub-index for 123 non-OIC countries stands at 44.37. In air pollution, household air quality and climate & energy indicators, the gulf between the performance of OIC and non-OIC countries is narrow, while for other indicators, OIC countries substantially fall behind. Thus, we see that in terms of carbon emissions, OIC countries perform well than non-OIC member countries. But, in a broader spectrum of environmental performance, OIC member countries perform less well.

Table 2 presents the comparison of economic and environment performance nexus. We categorize countries in 8 sub-groups. There are two economic dimensions, i.e. average GDP growth during 2002-12 and per-capita GDP in 2012. The ‘high’ and ‘low’ demarcation is based on the median rank. For instance, out of 171 countries, if a
particular country is ranked 35th in economic growth, 95th in per capita income (PCI) and 55th in average EPI during 2002-12, then it will be placed under high-growth, low per capita income and high EPI value sub-category cell. Thus, we would interpret that the country has above-median rank in economic growth, below median rank in per capita income and above median rank in EPI. The numbers in parenthesis represent the count of OIC countries in each of the respective sub-categories. We see that OIC countries feature prominently in both the categories of high economic and environment performance (11 out of 24) and low economic and environment performance (13 out of 27).

<table>
<thead>
<tr>
<th>Table 2: Comparison of Economic-Environment Performance Nexus</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPI Value</td>
</tr>
<tr>
<td>-----------</td>
</tr>
<tr>
<td>High</td>
</tr>
<tr>
<td>Low</td>
</tr>
</tbody>
</table>

The results illustrate the trade-off between economic and environmental performance. Only 4 countries with both lower economic growth and lower per capita incomes are able to get above median rank in EPI list. Countries with high median EPI rank are mostly the ones with high per capita incomes as well (70 out of 85). Countries with high growth, but low per capita incomes are likely to have below median rank in EPI. 80% countries with high growth and low per capita incomes obtain below median rank in EPI. Countries with high growth rate are not necessarily able to rank high in EPI. Interestingly, we can see that only 35 out of 85 countries with above median rank in economic growth are able to achieve above-median rank in the EPI list.

On the other hand, countries with low growth, but high per capita incomes are likely to have above median rank in EPI. 84% countries with low growth and high per capita incomes obtain above median rank in EPI. This sub-category is the perhaps the most ideal trade-off between economic and environment performance nexus. However, only Brunei and Tunisia are two OIC countries in that sub-category. 38 out of 54 OIC countries in our results have below median per capita incomes. In the other 16 OIC countries which feature in above median per capita incomes, 13 of them are able to achieve above median rank in EPI.

**Conclusion**

In this paper, we discussed the philosophy of Islamic life and its broad socio-economic implications in human behaviour. We also discussed how Islamic environmental ethics is harmonized with environment related SDGs and provide the necessary impetus for affirmative and responsible behaviour towards achieving these SDGs. Our comparative assessment of OIC and non-OIC countries showed that OIC countries perform relatively well in total carbon emissions and some of them have begun the transformation towards using renewable energy. But, in a broader spectrum of environmental performance, OIC member countries perform less well. In air pollution, household air quality and climate and energy indicators, the gulf between the
performance of OIC and non-OIC countries is narrow, while for other indicators, OIC countries fall behind. Thus, as Ansary (2010) concludes, we see that the primary problem in the Muslim world regarding the environment has been one of application rather than lack of theory.

References


Exploring the Significance of Islamic Environmental Ethics….


Project-backed Sukuk: can it be a model for resource mobilization, risk sharing and capital market development in developing economies?

By Bukhari M. S. Sillah*

Abstract

This paper reviews the comparisons between asset-backed and asset-based Sukuk using a number of criteria including Islamic contract principles and return types. Based on contract principle, asset-based Sukuk are found to account for 62% of global Sukuk and asset-backed 19%. Based on return type criterion, asset-based Sukuk constitute 98% of global Sukuk and asset-backed 2%. Project-based Sukuk are becoming a familiar financing model for developing economies. However, they are also generally asset-based. The paper finds that it is inappropriate to use only asset-based instruments to finance the public projects from construction to operation phases. This is a one-size-fits-all model, and it ignores the facts that some projects are social and others are economic, and that the construction phase, which generates no return, requires financing customization. Asset-based instruments delink the underlying asset from the financing and obscures the good governance practices to which the underlying asset should be subjected. Delinking the underlying asset from the financing leads to debt proliferation and accumulation, which are a recipe for a financial bubble and crisis. The paper proposes a project-backed financing model that uses quasi-equity instruments. It classifies public projects into either a social infrastructure or an economic infrastructure and tailors accordingly the financing instruments and the investor types. Social

* Author: Bukhari M. S. Sillah, ERPD, Chief Economist Complex Islamic Development Bank. E-mail: bukharisillah@gmail.com

Disclaimer: The opinions, conclusions and recommendations in this paper do not represent the Islamic Development Bank.
investors should play a key role in the construction phase, and financial investors can use asset-based instruments to participate in this construction phase. After delivery of the asset, the asset-based instruments should convert into asset-backed instruments to prevent massive build-up of debt and to maintain long-term development financing sustainability

Key Words: Asset-based Sukuk, infrastructure, capital market, financing, instruments.

1. Introduction

Resource mobilization is a key determining factor of success of multilateral development banks, and it is so special for the Islamic Development Bank. Other development banks can issue IOY (I Owe You) certificates to raise funds from the financial markets, while the Islamic Development Bank to be compliant with its Shari’ah principles of financing, has to issue asset-backed or asset-based Sukuk (bonds) to raise funding for its operations. Asset-backed Sukuk are investment certificates that are generally backed by real assets, whose ownerships are transferred to the Sukuk holders. Issuing Sukuk backed by assets not owned by the issuer can tantamount to short selling and ‘Gharar’ (uncertainty). Asset-based Sukuk are Islamic debt instruments that generally emanate from sale contracts of underlying assets. Asset-based Sukuk are ultimately delinked from the underlying assets. They can use the principles of Istitina, Salam, Ijarah and Mudarabah. Holders of asset-based Sukuk using Salam and Istitina principles take delivery of the underlying assets and then decide on exit strategies to implement. Salam assets are generally homogenous with available market, and thus the Salam-Sukuk holders can easily exit by immediately selling the underlying assets. The Istitina assets are often heterogeneous and customized. The Istitina Sukuk holders will wait to sell the assets over a long period, or transfer their ownerships to third parties, who are willing to wait, in a secondary market. They are needed for short-term financing and for tapping into the deep credit supply of fixed-income investors. Asset-based Sukuk mimic the conventional bonds, and they cannot claim to have superior advantage over the conventional bonds in economic and financial stability, as both involve in risk shifting and heavy debt proliferation. In the long run, the asset-backed Sukuk have to take over the financing to scale down the debt accumulation and promote the economic and financial stability. Asset-backed Sukuk create assets for the Sukuk holders. They apply principles of Musharakah and Mudarabah, and they often work like conventional equity stocks. They create assets that are to be managed as a going concern to generate income and capital recovery for the Sukuk holders. The holders of the Sukuk can exit by selling their ownerships to third parties in the secondary market through private or public transfers.

The public projects are long-term investments, and their financing should be matched accordingly. This paper argues that public projects should first be defined as either a social infrastructure or an economic infrastructure, and that the construction phase financing should be tailored differently from its operation phase. Asset-based Sukuk can dominate the construction phase, and asset-backed the operation phase and the project financing becomes quasi-equity. Increased use of debt instruments can question the whole purpose of Islamic financing, which premises its existence on participation and
risk sharing. The rest of the paper is organized as section 2 discusses and compares asset-backed Sukuk with asset-based Sukuk. Section 3 presents and analyzes the proposed model for public project financing. Section 4 concludes and draws the policy implications.


In this section, I review the comparisons between Asset-backed and Asset-based Sukuk. After presenting the literature definitions of Sukuk, I summarize several criteria for the comparisons, and I use sample data to provide evidence on the distribution of global Sukuk issuances in line with two criteria. Some reasons for the preference of asset-based Sukuk over asset-backed Sukuk are explained. I discuss some risks the asset-based instruments pose to the integrity of Islamic finance. Then, I present some challenges in implementing asset-backed Sukuk in development financing. A proposed model for the solutions of these challenges is covered by section 3.

Ayub (2007) asserts that Sukuk historically represented obligations emanating from trade transactions by the Muslim merchants, and they were considered a property of value. With the advent of Islamic capital market, Sukuk were issued to finance trade or investments, and they were accordingly known as ‘trade-based or participatory investment’\textsuperscript{1}. Audit and Accounting Organization of Islamic Financial Institutions (AAOIFI) defines Sukuk to be “certificates of equal value in common ownerships in shares and rights in tangible assets, usufructs, services or equity of given project or equity of special investment activity”, (AAOIFI, 2008)\textsuperscript{2}. Islamic Financial Services Board (IFSB) defines Sukuk to represent “proportional undivided ownership rights in tangible assets, or predominantly tangible assets, or business venture”, (IFSB, 2009)\textsuperscript{3}. The two definitions emphasize three things namely real underlying assets should exist against Sukuk are to be issued, the holders of Sukuk should own the real underlying asset and the holders should have common ownership, no one holder has a privileged ownership over others. Linking the Sukuk to the quality and revenue streams of the underlying assets has made Sukuk to be hailed as a key factor of economic and financial stability by preventing unsustainable leveraging in the capital market. This belief was shaken during the 2007-2008 financial crisis when some Sukuk claimed to be asset-backed defaulted. It was uncovered that the defaulted Sukuk were not truly backed by the underlying assets. They were then known as asset-based. IFSB\textsuperscript{4} defines them as either pay-through Sukuk that have repurchase undertaking by originator, or pass-through Sukuk that have an issuer guarantee in the case of default by the originator. The asset-backed ‘Sukuk satisfy the requirements for being asset-backed as certified by independent rating entity’, (IFSB, 2009). The holders of asset-backed Sukuk bear asset risks from the fluctuation of market value of the underlying assets, and the holders of asset-based Sukuk bear the credit risk from the probability that the issuer or the originator will not pay the agreed upon returns and principal. Sukuk can also be classified as asset-based or asset-backed depending on the Shari’ah principles of contract deployed, Dusuki and Mokhtar (2010). Using the

\textsuperscript{1} http://www.iefpedia.com/english/wp content/uploads/2013/06/30_April_12_Asset_based_vs_asset_backed_sukuk.pdf
\textsuperscript{2} https://islamicbankers.files.wordpress.com/2008/09/aoaifi_sb_sukuk_feb2008_eng.pdf
\textsuperscript{4} ibid
principles of contract and the definitions provided by AAOIFI and IFSB, I derive criteria to compare the two types of Sukuk, as presented in table 2. In sale contracts of Murabahah, Salam, Istisna with the price paid or deferred, the seller will ultimately part with the object of sale in exchange of the price. The seller faces the credit risk with the payment of the price, and the buyer faces the counterparty risk that the seller may fail to deliver the object of sale. Similarly, Sale-based Sukuk holders own debt on the issuer and do not own the underlying assets. In Ijarah (leasing), the Sukuk holders own the lease payments when due, and the underlying asset will be ultimately bought by the lessee at a face value, and it becomes asset-based. It will be asset-backed if the lessee repurchases the underlying at a market price, (AAOIFI, 2008). Returns on asset-based Sukuk are generally pre-determined and fixed; they do not depend on the revenue flows of the underlying assets. The asset-backed Sukuk returns are often variable, and they require gestation periods to allow the underlying to start performing and producing profits. Thus, rating agencies treat asset-based Sukuk as conventional bonds, where issuer credit quality is more emphasized than the underlying asset quality. In asset-backed Sukuk, the quality and financial performance of the underlying assets are emphasized more than the issuer quality, Ahmed (2010), and Dusuki and Mokhtar (2010). As a result, Bassen et al (2013) assert that asset-based Sukuk merely ‘mimic Anglo-American norm of financial modernity’ at the expense of developing an independent alternative Islamic finance.

**Table 2: Asset-Based versus Asset-Backed Sukuk**

<table>
<thead>
<tr>
<th>Designation by</th>
<th>Asset-Based Sukuk</th>
<th>Asset-Backed Sukuk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principle of contract</td>
<td>• Bay Bi Thaman Ajil</td>
<td>• Mudarabah</td>
</tr>
<tr>
<td></td>
<td>• Murabahah</td>
<td>• Musharakah</td>
</tr>
<tr>
<td></td>
<td>• Salam</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Istisna</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Ijarah</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Ijarah Bi Tamlik</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Ijarah Mawsufah Fi Zimmah</td>
<td></td>
</tr>
<tr>
<td>Rating Agency</td>
<td>• Unsecured Sukuk</td>
<td>• Secured Sukuk</td>
</tr>
<tr>
<td></td>
<td>• Half Sale (no perfection of transfer)</td>
<td>• Full sale (true and perfect transfer)</td>
</tr>
<tr>
<td></td>
<td>• Recourse to the originator</td>
<td>• Recourse to the underlying asset</td>
</tr>
<tr>
<td></td>
<td>• Asset on the balance sheet of the originator</td>
<td>• Asset not on the balance sheet of the originator</td>
</tr>
<tr>
<td>Investor’s Risk</td>
<td>• Credit risk</td>
<td>• Asset risk</td>
</tr>
<tr>
<td></td>
<td>• Shari’ah compliance</td>
<td>• Legal compliance</td>
</tr>
<tr>
<td>Return type</td>
<td>• Pre-determined as percentage of the initial layout</td>
<td>• Forecast at the initiation of the contract</td>
</tr>
<tr>
<td></td>
<td>• Generally fixed</td>
<td>• Dividend as a share of profit</td>
</tr>
<tr>
<td></td>
<td>• Generally Unrelated to the performance of the underlying asset</td>
<td>• Dependent on the performance of the underlying asset</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Variable</td>
</tr>
</tbody>
</table>
From 2729 Sukuk issuances, I attempt to find evidence for the extent to which Sukuk have mimicked the conventional bonds. Based on the criterion of contract principles, I find asset-based Sukuk to dominate the Islamic capital with 62% of the issuances, and asset-backed constitute 19% of the Sukuk issuances. Hybrid Sukuk, which are quasi-equity Sukuk, account for 9% of the issuances (see table 3). Wouters (2011) has advocated for increased utilization of quasi-equity Sukuk to meet aspirations of fixed investors and the same time improve the integrity and Shari’ah compliance of Islamic finance. Some Sukuk issuances do not state the contract principles, and this category constitutes 10% of the issuances. This non-disclosure of the contract principles raises suspicion that they are either asset-based, or their Shari’ah compliance is controversial. Overall, Sukuk Murabahah and Sukuk Ijarah form the largest shares of Sukuk issuances, and these contract principles fall under asset-based Sukuk.

<table>
<thead>
<tr>
<th>Table 3: Sukuk Designation by Contract Principle</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sukuk Type</strong></td>
</tr>
<tr>
<td><strong>Asset-Backed</strong></td>
</tr>
<tr>
<td>Sukuk Al Mudarabah</td>
</tr>
<tr>
<td>Sukuk Al Musharakah</td>
</tr>
<tr>
<td><strong>Asset-Based</strong></td>
</tr>
<tr>
<td>Sukuk Al Ijara</td>
</tr>
<tr>
<td>Sukuk Al Ijara,Al-Wakala Bel Istithmar</td>
</tr>
<tr>
<td>Sukuk Al Ijara,Sukuk Al Istisna's</td>
</tr>
<tr>
<td>Sukuk Al Ijara,Sukuk Al Murabaha</td>
</tr>
<tr>
<td>Sukuk Al Istisna's</td>
</tr>
<tr>
<td>Sukuk Al Murabaha</td>
</tr>
<tr>
<td>Sukuk Al Murabaha,Al-Wakala Bel Istithmar</td>
</tr>
<tr>
<td><strong>Hybrid</strong></td>
</tr>
<tr>
<td>Al-Wakala Bel Istithmar</td>
</tr>
<tr>
<td>Sukuk Al Mudarabah,Al-Wakala Bel</td>
</tr>
</tbody>
</table>
Examining the issuances by return type and assuming variable-return Sukuk to be asset-backed, I find only around 2% of the total Sukuk issuances to be asset-backed, and 98% of the issuances are asset-based (see table 4). Unexpectedly, Mudarabah and Musharakah contract principles appear also for asset-based Sukuk in table 4. These are two key contract principles of profit and loss sharing, and their returns should come from the revenue flows of the underlying assets. It is odd for Sukuk founded on these principles to have predictable and fixed returns. This implies that the issuers claim Mudarabah and Musharakah principles in their books, but they actually practice the requirements of asset-based Sukuk. This practice has caused defaults in Mudarabah and Musharakah based Sukuk in GCC as found by Taoual (2016). She finds that out of the defaulted Sukuk in GCC, 38% were Mudarabah-based, and 30% Ijarah-based. Because, contrary to the principle of Mudarabah, they provided certainty and guarantee of return and principal payment, which they failed to honor during the financial crisis. Their Sukuk were asset-backed in form and asset-based in substance.

**Table 4: Sukuk Designation by Return Type**

<table>
<thead>
<tr>
<th>Sukuk type</th>
<th>Within Group Percentage share</th>
<th>Sukuk type percentage</th>
<th>Distribution by contract type</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asset-Backed</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sukuk Al Ijara</td>
<td>3.92</td>
<td>0.07</td>
<td></td>
</tr>
<tr>
<td>Sukuk Al Mudarabah</td>
<td>72.55</td>
<td>1.36</td>
<td></td>
</tr>
<tr>
<td>Sukuk Al Mudarabah, Sukuk Al Murabaha, Al-Wakala Bel Istithmar</td>
<td>1.96</td>
<td>0.04</td>
<td></td>
</tr>
<tr>
<td>Sukuk Al Murabaha</td>
<td>3.92</td>
<td>0.07</td>
<td></td>
</tr>
<tr>
<td>Sukuk Al Musharakah</td>
<td>15.69</td>
<td>0.29</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>1.96</td>
<td>0.04</td>
<td></td>
</tr>
<tr>
<td><strong>Asset-Based</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Al-Wakala Bel Istithmar</td>
<td>8.03</td>
<td>7.88</td>
<td></td>
</tr>
<tr>
<td>Sukuk Al Ijara</td>
<td>17.25</td>
<td>16.93</td>
<td></td>
</tr>
<tr>
<td>Sukuk Al Ijara, Al-Wakala Bel Istithmar</td>
<td>0.78</td>
<td>0.77</td>
<td></td>
</tr>
<tr>
<td>Sukuk Al Ijara, Sukuk Al Istisna's</td>
<td>1.05</td>
<td>1.03</td>
<td></td>
</tr>
<tr>
<td>Sukuk Al Ijara, Sukuk Al Murabaha</td>
<td>0.34</td>
<td>0.33</td>
<td></td>
</tr>
</tbody>
</table>

Source of data: Bloomberg, Dec. 02, 2017
Sukuk Al Istisna’s 2.95 2.89
Sukuk Al Mudarabah 2.91 2.86
Sukuk Al Mudarabah, Al-Wakala Bel Istithmar 0.07 0.07
Sukuk Al Mudarabah, Sukuk Al Murabaha 0.49 0.48
Sukuk Al Murabaha 40.74 39.98
Sukuk Al Murabaha, Al-Wakala Bel Istithmar 0.22 0.22
Sukuk Al Musharakah 14.60 14.33
Sukuk Al Musharakah, Sukuk Al Ijara, Sukuk Al Istisna’s 0.04 0.04
Others 10.53 10.33

Source of data: Bloomberg, Dec. 02, 2017

Asset-based Sukuk face a number of issues, besides the default risk. They have limited liquidity as debt instruments are not tradable in Shari’ah, and AAOIFI bans trading of Sukuk that use a part of the underlying asset. Asset-based Sukuk require little regulatory and legal development, instead they are often diluted asset-backed Sukuk to conform to the existing regulatory and legal framework, Rasarati et al (2014). They hamper the efforts to develop new regulatory and legal platforms to accommodate asset-backed Sukuk resulting in benchmarking and ‘organizational mimicry’, Bassen et al (2013) and Iman and Mihajat (2015. Consequently, risks are not shared but shifted to one party. This practice can lead to massive accumulation of debt and a potential cause of a financial crisis, Noor and Shahimi (2013). For asset-based Sukuk to dominate Islamic capital market is a red flag for its integrity as it attempts to present itself as a true alternative to the conventional finance.

Asset-backed Sukuk are resilient financial instruments that knows no default, Ahmed et al (2015). They force practices of good governance into the financial market, because they demand thorough legal and financial due diligence and active management of the underlying assets to attract and keep the investors. It becomes more challenging when the underlying assets are public projects that can suffer from liquidity and economic risks. The public projects can ban or restrict foreign ownership violating the key requirements of asset-backed Sukuk. The public projects can be social infrastructure, which does not accept commercialization, and hence its Sukuk holders may not expect return streams from the underlying assets. Projects also have construction and operation phases, and they face completion risk. The underlying assets can only generate revenues during the operations, while the investors want to have returns on their investments during both phases, and they will be reluctant to bear the completion risks. I attempt to address these challenges in a proposed model of financing for public projects in section 3.

3. Project-backed Model of Development Financing

As section 2 reveals, asset-backed Sukuk do not appeal much to the investors for a number of reason. Asset and legal risks together with the investor’s aversion to risk have forced several issuers to dilute their Sukuk issuances to become asset-based. Thus, the
asset risk is replaced with credit risk, and variable return with fixed and certain return. The issuer quality replaces the quality of the underlying asset. This process tends to delink the financing from the underlying asset, and the financing becomes a debt instrument, which is not tradable in the secondary market and exposing the investors to liquidity risk. These risks may even grow bigger when they concern public project (infrastructure) financing. However, I attempt here to propose a model that can address these risks and the same time be Shari’ah compliant. I first explain the scope and assumptions of the model, from this explanation, I divide public projects into social and economic infrastructures, and each project has construction and operation phases that may demand different investor types. Then I summarize the analysis into a holistic diagram detailing how a project-backed Sukuk model works.

Scope and Assumptions

The model covers public infrastructure projects, which are assumed to be either a social or economic infrastructure. Each project consists of construction and operation phase. The operation phase delivers a value (asset) usable by the public without exclusion. The public is willing to pay, directly or indirectly through their representative government, for the use of the asset. Social infrastructure is not an income-generating asset, and thus it does not demand users to pay direct fees. On the other hand, economic infrastructure is an income-generating asset, and it demands its users to pay direct fees. I divide investors into short-term and long-term horizon investors. The short-term investors are assumed to choose certain income and capital preservation, and the long-term investors choose growth and liquidity. The construction phase is a short-term horizon, and the operation phase is a long-term one. The financing model is to match short-term investors with construction phase and long-term investors with operation phase. It looks paradoxical to bring short-term investors to the construction phase, when no income is generated and the underlying asset is yet to be delivered. The model achieves this matching (to be detailed later) by satisfying the demands of the short-term investors. The short-term investors are assumed to exit after the construction and delivery of the underlying asset.

Social infrastructure financing

Social infrastructure does not generate income to maintain themselves much more to pay returns on its initial capital layout. The public collectively own it, and their representative government is tasked to operate it free of charge for the benefits of all. The money spent to construct and operate comes from general tax revenues. Thus, in constructing a social infrastructure, no private financial investor can be reasonably convinced to place his/her money in these projects. Social investors, who demand no returns but capital recovery, can finance the construction phase of the social infrastructure. Examples of these social investors are Qard Al-hasan, Wagf and philanthropist funds. These investors can earn returns on their capital using zero-coupon Sukuk Istisna and investments of undisbursed funds. That is, they pay to construct the asset, which after delivery will be sold to the long-term investors. If the social infrastructure to be constructed is an extension of an existing income-generating state-owned company, then the social investors can earn dividend income from this holding
company through share purchases. Figure 1 shows the flow chart of the financing model for a social infrastructure.

The social investors will exit by transferring the finished asset to the long-term investors. The only long-term investors in social infrastructure are the government and the quasi-government. They will replace the short-term social investors by refunding the construction capital layout. The exit strategies are outright Istisna sale or lump sum repayment of the social capital. This means, general tax revenues and social investors should construct social infrastructures. The social investors can use Qard Al-hasan, Wagf and zero-coupon Sukuk Istisna to participate in the construction financing. They exit by transferring the constructed asset through outright Istisna sale and lump sum refund of Qard Al-hasan and Wagf capital.

**Figure 1: Financing Structure for a Social Infrastructure**

- **Social Investor**
  - Construction Phase
    - **Short-term Investors**: Government, Social Investors
    - **Financing tools**: Qard Al-hasan, Philanthropist funds, Wagf, Zero-coupon Sukuk Istisna
  - Exit Strategies of Short-term Investors
    - **Exit tools**: Qard Al-hasan refund, Wagf refund, Social capital refund, Istisna sale-formal purchase, Gift
  - Operation Phase
    - State-owned Asset

**Economic Infrastructure financing**

Economic infrastructures are expected to generate fair market returns or user fee revenues, which are at least enough to maintain and grow the infrastructure assets. Both short-term and long-term investors in economic infrastructures expect to earn returns on the capital investments. In the construction phase, the short-term investors can use zero-coupon Sukuk Istisna, Sukuk Istisna with Ijarah Mawsufah Fi Zimmah, and Asset-based Sukuk Ijarah on other income generating assets of the beneficiary of the would-be
economic infrastructure. In Ijarah Mawsufah Fi Zimmah, the investors can earn lease income on a specified asset that is being constructed. Social investors can also participate in the construction of the economic infrastructure using the social financing instruments mentioned before in the case of social infrastructure construction. Figure 2 shows the flow chart of financing model for an economic infrastructure.

**Figure 2: Financing Structure for an Economic Infrastructure**

![Financing Structure for an Economic Infrastructure](image)

The short-term investors will exit by selling the constructed asset to the long-term investors using asset-backed Sukuk, and the government should partake in the purchase as one of the long-term investors, so that the ultimate beneficiary keeps its stake of ownership in the underlying asset. The constructed asset after financial and legal due diligence will be bundled in Sukuk Mudarabah, or Musharakah, or Ijarah with true sale concept. A secondary market will exist for the long-term investors to exit by selling to third parties and to the ultimate beneficiary (represented by the government). The Sukuk will have a maturity thereupon they will be redeemed at fair market valuation prices. This redemption can begin earlier as the government periodically increases its ownership share using the concept of Musharakah Mutanagisah (diminishing partnership), where one partner buys gradually the shares of other partners to become a sole owner. This financing model shows that development projects should be first classified as social or economic infrastructure to help tailor accordingly the investor types and financing instruments. Social infrastructures are not self-financing, thus social investors (including the government) should construct it, and the government has to purchase it after the
construction. Economic infrastructures are self-financing; they can use social funds and asset-based Sukuk to finance the construction, and then asset-backed Sukuk to transfer them to the long-term investors. The Asset-backed Sukuk investors can transfer the Sukuk ownership to third parties in the secondary market or periodically to the government, which ultimately redeem the Sukuk at a specified maturity. Figure 3 illustrates how project-backed financing model works.

**Figure 3: Project-Backed Sukuk Financing Model**

1. People identify and recognize the need and value for an asset to be constructed and profess willingness to bear responsibility for it. They elect and appoint government to represent them.

2. Government contract with an Islamic Financial Institution (IFI) to finance and construct the asset.

3. IFI sets up a special purpose vehicle (SPV) to mobilize financial resources and construct the assets. IFI can earn fees for being an agent or profit for being a partner in delivering the asset.

4. Social investors play a key role in financing the construction, and participate as short-term investors. They earn gestation returns through Ijarah Mawsufah Fi Zimmah or asset-based Sukuk on other assets. They receive proceeds of Zero-coupon Istisna sale. They can get back their capital, or donate a part or a whole of it.

5. Financial investors play a key role in the operation phase as the asset becomes self-financing. They use asset-backed Sukuk. They can finance construction phase and receive gestation returns. They can exit using secondary market and Sukuk redemptions by the ultimate owner of the asset.
6. SPV uses the mobilized financial resources to construct the asset, operate it, record revenues and distribute incomes to Sukuk holders.

7. Consumers pay fees and prices to SPV for the use of the asset.

8. SPV delivers the assets to the representative government through redemptions of the ownership shares of other stakeholders in the asset.

Combining the two financing structures (of social and economic infrastructures) in figure 3 produces six key features of the model. First, it starts with people, who are the ultimate beneficiary of any public infrastructure project. They have to identify and know the asset to be constructed. They should understand the value of the asset to them and their responsibility toward the asset. Second, people should know whether the asset is going to be social or economic infrastructure. Their expectations about the utility, fees and prices with respect to the asset should be clarified. Third, people should elect and appoint the government to contract on their behalf the terms and conditions with the Islamic financial institution to finance and construct the asset. Fourth, the Islamic financial institution should profile its investor/financier base into social and financial investors. Financial investors want predictable returns on the investments, and social investors want to have a positive change in people’s lives. Social investors can play a key role in the construction phase to deliver an asset to the people; and the financial investors play a key role in the operation phase, when the asset becomes self-financing. Fifth, overall financing model from construction to operations of the asset becomes quasi-equity. The construction financiers use asset-based instruments, which are debt instruments, and they exit with the completion of the construction. The operation-phase investors use asset-backed instruments, which are equity instruments. The model matches asset-based instruments with short-term financing, and for the construction phase, and the asset-backed instruments with long-term financing, and for the operation phase. This process prevents massive accumulation of debt over time as debts convert to equity when projects move from construction to operation. Risks can be shifted, in the short run and during the construction using debt instruments, but they have to be eventually shared to achieve economic and financial stability in the long run. The conversion of the construction financing instruments into tradable asset-backed Sukuk contribute to the local capital market development and growth. Finally, the model institutes and relies on good governance. It requires the involvement of the people, who are the ultimate beneficiary, from onset to the delivery of the asset. This good governance practice extends to the underlying asset, which should be subjected to thorough legal and financial due diligence to qualify it to become an underlying asset for asset-backed Sukuk.

4. Conclusions and implications

Resource mobilization for development financing requires principles of partnership and not risk shifting and debt proliferation. Islamic finance was initially hailed for having dimensions of partnership in financing practices. However, its current heavy reliance on asset-based instruments has a potential to tarnish the integrity of Islamic finance. Based
on contract principles, 62% of Sukuk issuances are asset-based; and based on return types, this proportion goes to 98%, and asset-backed Sukuk constitute 19% and 2% respectively. Asset-based Sukuk are generally debt instruments, and it is alarming to find debt instruments are dominating the Islamic capital market. Instead of chartering its own way of financing, the Islamic finance is found to endeavor hard to mimic and conform to the requirements of conventional bonds. To prevent an Islamic financial crisis, the Islamic finance should move to quasi-equity instruments. This is particularly important when it comes to public project financing. Public projects can be a social infrastructure, which cannot be self-financing, or an economic infrastructure, which can sustain its financiers through revenue flows. However, projects generally have gestation periods before they can start generating revenues in the operation phase. It will be inappropriate to use asset-based instruments for financing both construction and operations phases of the projects. This will tantamount to strangulation of the projects due to accumulated debts over periods when the projects are yet to produce revenues. Asset-based financing also disconnects the underlying projects from the financing, and the result is absence of good governance with respect to financial and legal due diligence of the underlying projects. This paper argues that public projects are either a social or an economic infrastructure, and that both social and financial investors should be involved in financing the public projects. Short-term investors can use asset-based instruments to finance construction phase of the projects; and the long-term investors can use asset-backed instruments to finance the operation phase. Overall, the financing model of the project becomes quasi-equity with debt instruments dominating the short-term construction phase and the equity instrument dominating the long-term operation phase. The social investors can lead the construction financing and the financial investors the operation financing. It shows that as a project is being constructed debt is accumulated, but mainly from social investors, who can forgo or postpone return payments. The accumulated debt is then converted into equity as the project moves into the operation. This practice moves the debts into equity over time, contrary to the general practice of asset-based Sukuk that dilute equity into debt over time. Thus, project-backed financing model promotes economic and financial stability and contributes to the capital market development of developing economies. In this model, risks can be shifted using asset-based instruments, but only for a short period as the asset is being constructed, and then they are shared as the asset becomes self-financing by generating revenue flows for its investors. Social infrastructures may not be self-financing even during operation phase, and in this case, the social investors and the government should ultimately share the risks and the financing of the underlying asset.

References


Aggravating housing situation:
Return and ownership issues in Islamic home financing revisited

By
Zubair Hasan

Abstract

In my latest article on Islamic home financing models in the ISRA Journal, June 2013, I had shown that the Zubair Diminishing Balance Model (ZDBM) does not involve compounding of return and the transfer of ownership to the customer perfectly matches the payments’ rate; the two norms of Islamic models must meet. It is satisfying to note that Nabil in the same issue of the journal takes up these issues in a comprehensive and tightly argued conceptual paper and convincingly vindicates my position on the compounding issue. However, he argues that the transfer of ownership in the ZDBM also does not meet the stated ideal even as it is closer to the norm than other constructs. The objective of this paper is to clarify my position on this latter issue albeit I shall put on record a more clinging demonstration of interest compounding in the conventional formula as many Islamic banks use it not only in home financing but in other deferred payment contracts as well.

Key words: Shari’ah norms; home financing, Ownership transfer; Segmental murabahah

1. Introduction

The importance of a residential accommodation can hardly be over emphasized in civilized living. That is why Islam counts housing from its very inception among the basic human needs which must be met for all individuals living in a Muslim country. It also is true that housing shortage remains an agonizing reality not only in Muslim countries but throughout the world. It is surprising that even the most developed of

* Author: Zubair Hasan is Professor of Islamic Economics and Finance at INCEIF the Global University of Islamic Finance, Kuala Lumpur. The views expressed in this article are of the author’s and need not in any way be attributed to the institution where he works.
modern societies are not having full provision as Figure 1 depicts though very recent data was not available. Interestingly, the infamous 2007-2008 housing debacle in the US was the result of heightened speculation, not of action to provide a roof over the heads of the homeless.

In view of the huge backlog and increasing shortage of housing in developing countries, the issue has gained urgency across the globe. Natural calamities and unceasing wars in the Muslim world have made the situation all the more alarming. Recently the Islamic Development Bank (IDB) has initiated a massive program to ameliorate the situation in these countries. One result of the added attention to the housing problem in Muslim communities has been the search for a Shariah compliant model for home financing. The writings on the subject in the Islamic literature have been on the rise. The focal point in these discussions has been the consequences of the widespread use of a conventional formula for determining the periodic installment payments the client has to make to the bank to acquire complete ownership of the house.

![Figure 1](image.png)

*Source of data for construction: The Economist online, 30 March 2002*

In the ongoing discussion the paper of Nabil (2013) has convincingly established that Islamic home financing models in current use involve compounding of return on capital – interest, rent or mark-up – if the Excel formula is used for the determination of a uniform periodic installment payment. However, the paper argued that in the ZDBM too the ownership to the customer does not pass pro rata albeit he finds the results much closer to that ideal compared with other models (PP. 70-74). For this demonstration Nabil

---

1 Nabil looks vacillating on the point (2013; 40, 77-78). A critic presumably taking cue from Nabil wrote to me that the Excel formula does involve compounding but its Islamic condemnation is confined to interest and as Islamic banks take rent or profit, not interest no objection can be raised to the compounding of returns in their case. He provided no juristic documentation on the point. To me, the fixity of rent/profit rates in the MMP and the admission of their compounding make the model identical to the conventional in form and substance. The analogy of interest compounding is solid I believe to dismiss the stated speculation on compounding in Islamic financing.

2 See the Appendix where it is demonstrated that any fixed installment ----
uses what he calls the dynamics of outstanding balances in Islamic home financing models. The objective of this small note is to correct this misconception about the ZDBM.

To open the discussion, let me reiterate that what I call the pro rata transfer of ownership to the customer is the epitome of justice in Islam. Justice means equality before the law: the Scripture does not permit withholding from the people what rightfully becomes due to them. A tradition says: pay the wages of the worker before his sweat dries up. The Qur’an unequivocally instructs the believers not to usurp each other’s property using unjust means (2:188 and 4:29). Justice is the crux of the matter for calling something Islamic. Another verse (16:90) says:

> Behold: God enjoins justice, and the doing of good, and generosity towards one’s fellow men, and He forbids all that is shameful and all that runs counter to reason, as well as all envy, and He exhorts you repeatedly so that you might bear all this in mind.

The transfer of property at a rate slower than the payment rate must possibly be avoided more so as the ability to predict the course of events in an economy is extremely limited (Ormerod 2010). The track record of forecasting is very poor. We shall demonstrate that the ZDBM meets that norm to perfection. Nabil’s claim that it does not is based on a misinterpretation of what he calls the dynamics of outstanding balances. The following section provides a clarification on the point.

### 2. The Dynamic Balance

The argument in Nabil centers around the changing balance of the payment that remains outstanding as installments are progressively paid until this balance is reduced to zero. However, note that outstanding balances are the consequence not the cause of how the installment is determined. In focusing at that end Nabil is perhaps putting the cart before the horse. It is fixity of installment that is the basic and common point in all

---

It is argued that the reason for the prohibition of riba imputed to IbnRushd is its potential to inflict extreme injustice. El-Gamal (2014) perceives its presence even in pure mudarabah contracts. He writes that there is nothing in the Islamic rules of mudaraba that prevent the capitalist from offering the worker a share of profits, which could turn out to be grossly unfair relative to his market wage. If the worker has no access to other work, this ostensibly Islamic partnership model contains the possibility of allowing severe exploitation: the worker may be forced to earn much less than his market wage with unwanted risk to boot. That is the very same extreme injustice (ghubnafahish) for which riba is but one vehicle.

It is argued that the reason for the prohibition of riba imputed to IbnRushd is its potential to inflict extreme injustice. El-Gamal (2014) perceives its presence even in pure mudarabah contracts. He writes that there is nothing in the Islamic rules of mudaraba that prevent the capitalist from offering the worker a share of profits, which could turn out to be grossly unfair relative to his market wage. If the worker has no access to other work, this ostensibly Islamic partnership model contains the possibility of allowing severe exploitation: the worker may be forced to earn much less than his market wage with unwanted risk to boot. That is the very same extreme injustice (ghubnafahish) for which riba is but one vehicle.
deferred payment contracts using Excel formula, housing included. The essential point here is how to define the outstanding balance? Should the definition of deductible payment to find this balance with reference to ownership transfer be the sum of (i) the amount of capital returned plus (ii) the return on capital after each installment is paid or it should include only the first of these two elements? The basic difference between Nabil and the present author is on this point. To arrive at his dynamic (outstanding) balance, Nabil includes both as deductibles. On this criterion, he finds the BBA model of home financing alone meeting the ideal; home ownership transfer to the client pro rata as his Figure 1, on page 72 shows.

The reason is that in the BBA the total amount payable to the bank is settled once for all. The periodic installment may be calculated for uniformity and comparison by inserting the principal ($P_0$) the agreed rate of return ($r$) and number of time units ($n$) into the Excel formula (See Nabil 2013, P. 42 & Table 1). The sum of installments that is the principal amount plus the full period return on it became a loan via a *murabahah* (markup) based contract. In BBA, it was this conversion of return on capital into debt that led banks into trouble when in a case of breach or early offer of settlement the amount they claimed as unpaid was challenged and held as unjust in law courts (Zulkifli vs Affin Bank, December 2005). Later on the grant of *ibra* (discount) was introduced into the picture to overcome the difficulty and provide relief to the customers in such cases. The grant of *ibra* is discretionary though, the banks commonly use it.

---

El-Gamal claims that many classical jurists had classified *mudaraba* as *ijara bi-l-gharar*; hire with (forbidden if excessive) uncertain wage. It may also include an element of *riba* in the sense that the profit share is not commensurate with the work done, fairness being determined by the market wage, as many classical jurists also have determined. The message is to call a transaction "Islamic," it must be fair in some clear sense. He concludes that there is no amount of juristic (*fiqhi*) analysis of contract forms that will help you determine whether or not there is injustice in the exchange. If one cannot refute him, the conclusion is a serious challenge to those who see the solution of all monetary ailments that afflict the world today in universal *Risk Sharing scheme* and interestingly, insist on keeping it distinct from profit (loss) sharing (Askari et al. 2012).

Starting from the consequence end has led Nabil (2013; 50) to conclude that the ZDBM model is not cheaper for the customer than the MMP in identical cases if time value of money is taken into consideration. But should not the aggregate payment under the ZDBM be at least smaller by the amount compounding adds, Nabil admits, to that payment in the MMP? Note that allowing a mark-up in deferred payment contracts is recognition of the time value of money. Once allowed it cannot be repeated as does compounding in the MMP (Hasan 2013; 14, 21).

“(T)he analysis is based on the notion that each element of the periodic installments can be accounted for in the balance” (Nabil 2013; 46). This assumption is untenable; it vitiates his entire argumentation and hybrid models

---

5 Starting from the consequence end has led Nabil (2013; 50) to conclude that the ZDBM model is not cheaper for the customer than the MMP in identical cases if time value of money is taken into consideration. But should not the aggregate payment under the ZDBM be at least smaller by the amount compounding adds, Nabil admits, to that payment in the MMP? Note that allowing a mark-up in deferred payment contracts is recognition of the time value of money. Once allowed it cannot be repeated as does compounding in the MMP (Hasan 2013; 14, 21).

6 “(T)he analysis is based on the notion that each element of the periodic installments can be accounted for in the balance” (Nabil 2013; 46). This assumption is untenable; it vitiates his entire argumentation and hybrid models

7 *Ibra*’ means to absolve a debtor from his debt obligation what has been established as his liability. Technically, *ibra*’ is “an act of absolving one’s financial rights established in another person’s liability which leads to discharging the other from liability to fulfill the obligation”. It is a unilateral waiver of right by a party to the contract which is granted out of his benevolence (*ihsan*) at his discretion. (Abdul Khir: 2013; 3).
The case of the BBA apart, it is *prima facie* illogical to merge the return of capital with the return on capital to discuss the issue of ownership transference to the customer. Return on capital is not a variable that exists independent of the return of capital. The bank focus is the latter alone; as long as capital remains unpaid interest accrues on the balance remaining unpaid. If the loan is cleared before time the interest payment stops simultaneously.

Thus, the relevant deduction for calculating the outstanding balance each time is only the return of capital. In a case of breach of contract, the bank will not accept from the sale proceeds of the property less than the part of capital that remains unpaid in the MMP model as in the conventional, assuming for simplicity that the market price of the house remains unchanged. On this view of what Nabil calls the *dynamic balance*, only the ZDBM meets the pro rata transference ideal; the MMP model does not. We have shown it earlier but we reproduce it here for completion of this brief note using the same illustration that we used in earlier writings and which our critics also found convenient to use for comparison.

### 3. Ownership Transfer – MMP versus ZDBM

In bare bones the illustration that Nabil also uses is as follows. The value of the house is $100,000 of which the customer contributes $20,000 and the bank provides the remaining $80,000 for 10 years payable in 20 uniform semi-annual installments. In the MMP the semi-annual installment is as usual calculated using the Excel formula at $5886.54. The amount includes both the return of capital and the return on capital components. It is this notion of installment payment that lies at the heart of Nabil’s analysis. However, the ZDBM sees the payments differently. It talks of the uniformity in the return of capital only i.e. $4000 semi-annually. The *murabahah* mark-up at 8% per annum replaces rental and is *segmental* i.e. applied to the diminishing balance at each time point. Thus, the total payment – return of capital plus return on capital – per period does not remain uniform as in the ZDBM. Table 1 compares the two positions.

<table>
<thead>
<tr>
<th>Semi annual periods</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on capital</td>
<td>Return of capital</td>
<td>Outstanding Balance (80,000 – B)</td>
<td>Total payment (A + B)</td>
<td>Return on capital</td>
</tr>
<tr>
<td>n</td>
<td>A</td>
<td>B</td>
<td>C</td>
<td>D</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>1</td>
<td>3200</td>
<td>2687</td>
<td>77313</td>
<td>5887</td>
</tr>
<tr>
<td>2</td>
<td>3093</td>
<td>2794</td>
<td>74520</td>
<td>5887</td>
</tr>
<tr>
<td>10</td>
<td>2981</td>
<td>2906</td>
<td>71614</td>
<td>5887</td>
</tr>
</tbody>
</table>

I must add in all humility that I did not make the needed distinction myself in earlier writings and used total periodic payment – return of capital + return on capital – as the basis of my demonstrations relating to the transfer of ownership to the customer. I realized the lapse after reading Nabil, especially after seeing the Figure on page 72 of his paper. I regret if this has in any way misled him.
Table 2 has been derived from Table 1 and Figure 1 is its graphic depiction. The straight line in the Figure shows the pro rata transfer of house ownership to the customer. In other words, at each point of the line we have:

\[
\text{Cumulative Amortization ratio \quad \text{Ownership transfer ratio} = 1}
\]

This is what happens under the ZDBM. In contrast, under the MMP cumulative amortization ratio remains less than pro rata transfer ratio (=1) as shown by the gap between the curve and the straight line until the last (20th) payment has been made. This is a serious matter from the Islamic viewpoint and must keep the contract inequitable and therefore void all along the line.

Source: Author's own construction
I have demonstrated that the use of the formula in Islamic finance models would possibly need a relook as the total payment – return of capital + return on capital – is the basis of their construction. To illustrate, we compare in Figure 3 the HFM-v model of Nabil with the ZDBM on the basis of data he provides for his model in Table 4, P. 64 of his paper.

It is easy to see that the two models are identical except that in the HFM-v Nabil adds the total mark-up $3200 to bank finance $80,000 and divides the sum $83200 by 20 to arrive at the uniform semi-annual installment = $4160. In its features the HFM-v is identical with the BBA model of home financing shares its blemishes in equal measure.

Appendix 1

The conventional loan amortization process is not free of compounding

The formula for determining the equal periodic installment payments (A) to clear the loan on time is as follows

\[ A = P_0 \frac{(1 + r)^n}{(1 + r)^n - 1} \]  

(i)

In our illustration we have \( P_0 = $80,000 \) semi-annual rate of interest 4%, and loan period \( n = 20 \) semi-annual units.

Substituting the values in the above formula we get:

\[ A = 80,000 \frac{.04 (1 + .04)^{20}}{(1 + .04)^{20} - 1} = $ 5886.54 \]

\[ P = 5886.54 \times 20 = n \times 117730.8 \quad (2) \]
I could isolate the compounding element in my earlier paper. It enters into the picture as the formula capitalizes the preceding period return on capital to arrive at the current period outstanding balance (Hasan 2013; 14-15). Thus, the compounding element can be obtained through multiplying the periodic return on capital each time by the periodic rate of return - interest rent or mark-up as in table 3 but the amount is too small for showing visibly in Figure 4 above. However, we know that the conversion of natural values into logarithm in a series gives greater weight to smaller values and less to larger ones. This enables one to make the compounding element vivid as in Figure 5.

**Table 3: Compounding element in Installment payments**

<table>
<thead>
<tr>
<th>Instalment #</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>19</th>
<th>20</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>R on C</td>
<td>3200</td>
<td>3093</td>
<td>2981</td>
<td></td>
<td>444</td>
<td>226</td>
</tr>
<tr>
<td>(R on C)*.04</td>
<td>128</td>
<td>124</td>
<td>119</td>
<td></td>
<td>18</td>
<td>9</td>
</tr>
</tbody>
</table>

Values in logarithms

Balance Cumulative Compound Log Cumulative payment, outstanding balance and

Based on the present and earlier demonstrations, I maintain my position that not only the formula in equation 1 but any logical method of determining a uniform periodic installment payment combining return of capital with return on capital will invite the
same sort of criticism as spelled out in my writings: it must involve compounding of return and an ownership transfer to the customer at a less than amortization rate until the last installment is paid.

There is another and more revealing way to identify compounding in the exercise. The bank receives a fixed installment of $5887 semi-annually. How the management looks at it internally is a matter of discretion. It is interesting to see that we may break the installment into average semi annual receipt of return of capital $4000, return on capital $1887 their sum being 5887semi-annual payment. Table 4 presents the result. It is interesting to see that the periodic return of capital remains the same ($4000) as in the ZDBM but the average return on capital is more each time average return is capitalised to calculate the outstanding balance as shown elsewhere. (Hasan2013, 14). Here the last row separates the element

Table 5: Break-up of installments into uniform Return of Capital and uniform Return

<table>
<thead>
<tr>
<th>Installment #</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return of Capital A</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
</tr>
<tr>
<td>Return on Capital B</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
</tr>
<tr>
<td>Installment A + B</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
</tr>
<tr>
<td>Return on Capital B *0.04</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Installment #</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>11</th>
<th>12</th>
<th>13</th>
<th>14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return of Capital A</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
</tr>
<tr>
<td>Return on Capital B</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
</tr>
<tr>
<td>Installment A + B</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
</tr>
<tr>
<td>Return on Capital B *0.04</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Installment #</th>
<th>15</th>
<th>16</th>
<th>17</th>
<th>18</th>
<th>19</th>
<th>20</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return of Capital A</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
<td>4000</td>
<td>80000</td>
</tr>
<tr>
<td>Return on Capital B</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
<td>1887</td>
<td>37740</td>
</tr>
<tr>
<td>Installment A + B</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
<td>5887</td>
<td>117740</td>
</tr>
<tr>
<td>Return on Capital B *0.04</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
<td>75.46</td>
<td>1509</td>
</tr>
</tbody>
</table>

References

Abdul Khir, Mohammed Fairooz (December 2013): *Ibra’ and its application in Islamic finance,* Fatawa in Islamic Finance: A joint Bloomberg& ISR online (monthly) publication


Privatization Predicament and Shari’ah Compliant Alternate Solutions

By
Malik Shahzad Shabbir*
Tasmia Matloob

Abstract
This paper proposes viable Shariah based alternate solutions to the privatization dilemma. Instead of privatization through outright sale of national assets, equivalent funds can be raised through long term Shariah structures without alienating national assets permanently. This will help safeguard public welfare and be in line with Maqasid al-Shari’ah, Hifzal al-Mall, and Mamala fiqh Marsala. Privatization of national assets is generally a matter of great public interest. This paper reviews reasonable arguments which do exist on both sides of the divide. Nevertheless, once privatization has been done reversing the process would be neither fair, nor justifiable and hence the balance of convenience in this public policy matter tilts, somewhat in favor of not privatizing national assets, if reasonable alternates are available, or possible for achieving most, if not all of the objectives which the privatization process is expected to achieve without permanently alienating national assets.

Keywords: privatization dilemma, national assets, spectrum, family silver, public policy.

Introduction
The matter of privatization becomes crucial when under-developed countries are unable to manage their financial resources to meet the needs of their nationals through the national assets. However, national assets play a vital role for the development of any country in the world. Almost, in all developed countries national assets are the key factor

* Authors: Malik Shahzad Shabbir, PhD (student) at school of Business and Economics, University of Brunei Darussaalm.
Tasmia Matloob, affiliated with International Islamic University, Islamabad.
E-mail: mshahzad786.pk11@gmail.com
for the progress of these nations. This study invokes a wide spectrum of reactions. This may range from indignation at alienating national assets permanently as tantamount to selling the proverbial ‘family silver’. It is observed that most of national assets were working very well in several developing countries but some sudden economic shocks, political instability in that country, financial crises and most important lack of top management are unable to maintain the proper flow of revenue from these assets.

Whereas, Merton and Bodie, (1995) facilitated the financial sector through the techniques of risk allocation in different segment such as firms and households sector, another important comment about financial sector was shared by Stiglitz (1994), where he identified some causes of market failure due to the intervention of state in financial sector of economy. Whenever the top management of national assets was facing these issues, they immediately contact the interest bearing institutions for financing on any terms and conditions for settlement of national assets through financial resources. Actually, in that particular position of top management, they must reduce extra funding programs internally or externally, focus on their entire budget and find out the core problem why they have become victim and improve their weak areas (Shabbir et al (2016)). However, it is also noted that some of top management people criticized their fellow beings in that condition to save themselves from culpability. These are in general, the reasons behind the privatization of national assets.

Now this study gives a snapshot, why government of Pakistan is interested in privatization of national assets. Actually, Government promotes the private – ownership in accordance to the principle of free economic market and this principle was launched first time by Prime Minister (PM) Nawaz Sharif on 22 January, 1991. Then, the promotion of free economic market principles was revised again in 1999 by PM Nawaz Sharif and finally 80% - 90% of national assets shares were converted into private ownership by PM Shaukat Aziz in 2007 (Ministry of Finance, 2007).

The State Bank of Pakistan (SBP) rated Meezan Bank as the first largest Islamic bank in 2002, which provided financing to Sui Southern Gas Company (SSGC) with PKR two (2) billion through Islamic bonds (Sukuk) on 31 May 2007 to meet the liquidity requirement of SSGC for their new projects of Natural gas and different business of transmission and distribution (SBP, 2002). After this several times Meezan Bank and Standard Charter Bank provided financing to SSGC in different projects. Actually, SSGC was formed in 1954 under the company act 1913 and was reshaped on 30 March, 1989 under the company ordinance 1984. Sui Northern Gas pipelines limited (SNGPL) was started in 1963 as a limited company and after some time this company converted into public company in January 1964 under company act 1913. Islamic Financial Institutions (IFI’s) played a vital role in both these companies as well as in two provinces of Pakistan through offering long term Sukuk in order to fill the liquidity issue for both companies. Both companies agreed on corporate solvent guarantees, which provides some positive effects on all parties through risk adjusted return on capital (RAROC), where it increases the profit of both companies, risk registered on capital decrease, return on investment increase and an increase on risk registered returns. Shiller( 2003) examined that sometimes the demand of higher returns leads to the behavior of moral hazard and it badly effects people to engaged in anti-productive activities of society.
In 1958, governments of Pakistan and Russia signed an agreement to launch a steel mill in Karachi through private and public cooperation in order to meet the needs of iron in both countries. However, this steel mill became a national asset on 30 December, 1973 under the nationalization program by government of Pakistan. It is noted that from last more than one decade this national asset is continuously facing financial crises and government has planned several times for the privatization of this asset but it had stopped through involvement and restrictions of Supreme Court of Pakistan. Islamic Financial Institutions (IFI’s) offer several shariah solutions of liquidity to government of Pakistan to save this asset from privatization but government has ignored it each times. In 1970s, the PM Zulifaqar Ali Bhutto announced nationalization programs in Pakistan, where all the private, semi-public and all other companies and institutions came under the control of government. This short term nationalization program has badly affected the Pakistan economy.

Actually during the last few decades, the internal and external environment of Pakistan was not fully supportive of our economy because the people who ruled over Pakistan in that period used it for their personal benefits and ignored the country benefits. (Shabbier et al (2015)). In FY 2004-08, the average economic growth rate was 7.1% in Pakistan, while in FY2005 the growth rate was 9.0%. (International Monetary Fund, 2008). The main task for Government of Pakistan and Ministry of Finance was in getting the confidence of international investors and which types of benefits they provided to different investors according to their investment levels or shares in our markets, so they didn’t withdraw their investments in our financial institutions and markets Shabbir et al (2016).

Our study consists of two parts, the first part of paper describes why some national assets become victims of privatization in different forms and second part of our study provides some Shariah alternative solutions for our national assets in order to save these assets from privatization. The core reason of privatization for national assets is shortage of liquidity, It also depends upon top management capability on whether that shortage of liquidity is a short time or continuously decline. There are three main ways of public private companies collaborations such as, public limited companies to private limited companies, Private to public limited companies and programs of nationalization in Pakistan. The government of Pakistan had five national financial institutions viz. National Bank of Pakistan, Habib Bank of Pakistan, Allied Bank of Pakistan, United bank of Pakistan and Muslim Commercial Bank of Pakistan in 1975 but now-a-day there is only one government financial institution and rest of four banks were privatized due to several reasons but most important reason was tussle among financial planning and policy makers.

**Literature Review**

It is observed that most of public and private companies’ management mainly depend upon human resources (HR) and finance department but especially on financial advisors of company. Financial advisors play a crucial role in the progress of any company in the world. It is the primary objective of any company to maximize its profit every year and it is also noted that stakeholder’s of a company prefer a company which
makes increasing profit every year. Most stakeholders do not know about what kind of resources employed to make this revenue for company each year. Coffin, (2009) shared his views as “risk management is a golden strategy for the organizations in order to protect their assets, risk reduced, return on capital increased and if loss occurs then mitigating it”. Risk management is further observed by Oldfield & Santomero, (1997) where they find that risk managers can be categorized into three categories, first one who loves risk and prefers those financial transactions which are more risky; second one are those people who take calculated risks and depend upon condition and nature of the transactions and finally those who primarily decide to eliminate the risk in every situation.

Several studies in existing literature such as El-Gamal (2006), El-Sheikh (2000), Karbhari et al. (2004) and Dar and Azami (2010) indicated the importance of Islamic finance and its ability to be quickly adopted as an alternative financial system from conventional finance. The conventional banks open “Islamic Windows” in order to meet the needs and wants of their customers because now customers demand conventional financial institutions for investment through shariah complaint modes of financing Derigs and Marzban, (2008); Grene, (2009) and Citi Islamic, (2012). Kaleem and Wajid, (2009); Obaidullah, (2002) noted that Bai Salam as a shariah complaint product is widely accepted in agriculture transactions. However, another instrument of shariah “sale with deferred payment” (Bai al - arboun) is strictly not allowed in Gulf countries because it was postulated to bring Gharar in the spectrum of modern Islamic financial system Dali and Ahmad, (2005); Obaidullah, (2002); Salehabadi and Aram, (2002); Obaidullah, (1998).

Lutufullah et al (2016) dissects the effect of Sharī'ah Compliance Perception on Customer Satisfaction, in Islamic Banking Sector of Pakistan. Primary data was gathered from 242 record holders of Islamic Banks and Islamic Banking Branches (IBBs) of conventional banks and broke down by relationship and relapse through self-regulated polls in light of SERVQUAL show. Huge directing impacts of Sharī'ah consistence recognition on the connection between benefit quality and consumer loyalty have been distinguished. As a cross sectional investigation with comfort inspecting confines generaliz ability, and since budgetary advantages offered by banks were excluded as a variable, the extent of this examination is constrained to benefit quality as it were. Future research may concentrate on the directing impact of Sharī'ah Compliance through longitudinal examination with bigger specimen measure in a multi-social condition. After effects of this paper prescribe Islamic banks to concentrate on their central quality “Sharī'ah Compliance” while building up their service and building promoting techniques.

Kaleem and Wajid et al (2009) explored the possible application of Bai Salam contract (forward sale agreement) as an alternative financial instrument in the agriculture sector of Pakistan. A survey was conducted in four districts of the Punjab with a specifically designed questionnaire. A convenient sampling technique was used to gather farmers’ concerns related to crops inputs, output and credit requirements. Empirical findings conclude that agriculture income represents only up to 60 percent of the income of an average farm household. About 70 percent of farmers participate in the credit
market. They need money to purchase crops inputs, to pay the labour and to hire rental machinery. Farmers believe that they can save up to 25 percent in costs if they purchase inputs in cash. The survey also discloses that middlemen are the larger financiers and buyers of crops in the rural economy whereby only 10 percent of transactions are conducted on a purely cash basis. Farmers usually return the money after the sale of the crop.

Shahid et al (2012) found determinants of growth of Islamic retail banking in Pakistan. The quantitative methodology is adopted in this paper, through three-fold approach. In first method, growth of Islamic banks is compared with conventional banks through financial statements key statistics for a period of recent three (3) years; in second method an instrument is used through customers of Islamic retail banks and their perspective is assessed; and in third methodology, another instrument is used through bankers of Islamic retail banks. findings include good bank spread, customers’ perspective of good returns on deposits and better services, apart from religious cause of trend for Islamic retail bank; banks’ perspective of better Islamic alternate to retail banking needs.

In his book "Economic health or illness" Dr. Mohammad Malkawi describes his views about the public and private company indexation in an international market through different worldwide standard of rating in these words "the most important index of economic well-being under capitalism is the index that monitors the growth of the nation's health as a whole. DOW Jones, NASDAQ, NIKO, NYSE and other indexes monitor the status of the nation's most powerful companies. A steady increase of these indexes does not record, or reflect the status of the poor in the nation. In fact the overwhelming data shows that poverty and hunger persist despite the steady increase of economic indexes over the years. The daily report of the economic indices proves one more time that capitalism is inherently concerned about the growth of products, rather than the satisfaction of the needs of the people."

**Shari’ah Compliant Alternate Solutions about Privatization of National Assets**

- Privatization of national assets is generally a matter of great public interest. It invokes a wide spectrum of reactions. This may range from indignation at alienating national assets permanently as tantamount to selling the proverbial ‘family silver’. Its proponents on the other hand also have a wide range of supporting arguments which range from leaner government, and the numerous benefits and efficiencies to be obtained from free market economies. This study reviews reasonable arguments which do exist on both sides of the divide. Nevertheless, once privatization has been done, reversing the process would be neither fair, nor justifiable, and hence, the balance of convenience in this public policy matter tilts somewhat in favor of not privatizing national assets, if reasonable alternates are available, or possible, for achieving most, if not all, of the objectives which the privatization process is expected to achieve, without permanently alienating national assets.

- Valuation and pricing of free-hold land and assets, as well as long term lease hold assets is likely to and does yield similar results. This is primarily because most
credible and reliable valuation and acceptable pricing models have cash flows based focus these take into account, inter alia, net present value of future cash flows etc. These are also reviewed. Long term lease of national assets can be done and some options are being proposed here as viable alternates to the privatization process. This includes long term Shariah with underlying Sale Lease Back or Diminishing Masharkaha (DM), which has an inbuilt Ijarah element in it.

- An outright sale permanently alienates the national assets. Whereas, credit enhancement options say by adding sovereign financial guarantee to a long term Ijarah Shariah structure and its near alternates can reduce the Risk Weighted Assets (RWA) due to the sovereign financial guarantee element and can improve the Risk Adjusted Return on Capital (RAROC), vis-à-vis an outright sale even for international investors seeking portfolio diversification. Alienating national assets permanently through outright sale in the privatization process may not be in line with safeguarding public welfare, Maqsaad al-Shari’ah, Hifzal al-Mall, particularly, when the same amount of funds can be raised through alternate Shariah based structures, where the national assets also revert and are not permanently alienated in greater public interest and Mamala Fiqh Marsala. Tangible national assets amongst other benefits and uses help facilitate in raising Shari’ah compliant financing, if required by maintaining and managing debt generation capacity at a macro level for any Islamic Economy.

- Other aspects are also reviewed and addressed. For instance, why would an investor invest in a public utility which instead of being privatized is given on a long term lease? There are solutions to these issues as well and Shari’ah compliant options are also available. Cases of Sui Northern Gas Pipelines Limited (SNGPL) and Sui Southern Gas Co. Limited (SSGCL) is presented. These are duopoly gas utilities in Pakistan catering for two provinces each with captive clientele, geographically covering north and south regions as their names suggest. Gas Development Surcharge (GDS) provides a fixed rental solution @ 17 % p.a. linked with their operating fixed assets. As long as their cost of financing is managed below this level, it provides a positive spread and an incentive to expand their network operating fixed assets and outreach even for remote villages without gas supply. In fact, an outright purchaser may have lesser incentive to reach remote villages, whereas, a long term Shari’ah structure using underlying lease or DM mode, ‘lease of the company’, rather than privatizing it in the first place along with addition of sovereign guarantee for credit enhancement and other incentives such as GDS would reduce RWA and simultaneously yield better RAROC than an outright sale. This will prevent the national assets to be sold and alienated permanently. Another important aspect which may only be ignored at peril to public policy interest is that some developing countries may not be able to ensure clean, transparent, corruption and commission free privatization process.

- The sale price of an asset or property may be estimated in terms of multiples of its Annual Rental Value (ARV) say even 10 to 12 times. Another Case-let covers instances where privatizations of financial institutions have been done at a pittance. Numerous instances exist where the profits being made each year are in double
digits billions and each year’s profits on its own for a number of financial institutions far exceed the total price obtained in the privatization process with full management control shift sale of companies with greater breakup value national assets being sold at a pittance at an ‘ARV’ of around one time only.

- In view of the foregoing, it is being proposed here that in greater public interest public policy on privatization warrants fresh reconsideration for Islamic economies. Instead of privatization through outright sale of national assets equivalent funds can be raised through long term Shari’ah structures without alienating national assets permanently. This will help safeguard public welfare and is in line with Maqsaad al-Shari’ah, Hifzal al-Mall, and Mamala Fiqh Marsala.

**Conclusion**

The government and its policy makers clearly indicate through their policies and different interviews or programs on social media that their internal and personal matters are the key source of privatization of national assets. Recently, same activities were performed such as, privatization issue of Pakistan International Airline (PIA) by Pakistan Muslim Leagues in the last and first quarter of 2015 and 2016 respectively. Whereas, some of Islamic and conventional financial institutions were ready to fulfill the liquidity issue of PIA, but government of Pakistan does not support them. This recent issue describes a worst example of governance. However, valuation and pricing of free-hold land and assets, as well as long term lease hold assets is likely to and does yield similar results. This is primarily because most credible and reliable valuation and acceptable pricing models have cash flows based focus these take into account, inter alia, net present value of future cash flows etc. These are also reviewed. Long term lease of national assets can be done and some options are being proposed here as viable alternates to the privatization process. This includes long term Shariah with underlying Sale Lease Back or Diminishing Masharkaha (DM), which has an inbuilt Ijarah element in it. Its proponents on the other hand also have a wide range of supporting arguments which range from leaner government and the numerous benefits and efficiencies to be obtained from free market economies.

**References**

Citi Islamic Investment Bank (2012), Annual report.


Dali, N. R. S. M., & Ahmad, S. (2005, August), A Review of Forward, Futures, and Options from the Shariah Perspective. “From Complexity to Simplicity”. In *Conference on Seminar Ekonomi&Kewangan Islam* (pp. 29-30)


Grene and Sophia (2009), "Moves afoot to plug gap in Islamic finance." *Financial Times*


State Bank of Pakistan (2002), an annual report published by SBP.


Country Model

Maldives

Maldives, whose population of around 400,000 people is dispersed over around 200 islands, has an economy mostly based on tourism and fisheries. Since last few years, Maldives is also making a name for itself in the Islamic finance industry. With a strong commitment from government to position the country as a South Asian hub for Islamic finance and the Halal sector, the country has recently built its Islamic finance industry.

Regulatory Environment

The basic regulatory infrastructure for Islamic finance has been provided by the Government of Maldives. The sector is being regulated by the Maldives Monetary Authority (MMA) and the Capital Market Development Authority (CMDA). Shariah banking falls under Islamic Banking Regulations 2011, overseen by the MMA, while the CMDA has enacted several regulations for the Islamic capital markets including for Sukuk issuance and Islamic securities screening. In 2015, a Zakat bill and regulation for Waqf were also drafted with the assistance of the IDB and the Islamic Research and Training Institute. Due to few legal gaps, the regulators are currently working on developing a more comprehensive and effective regulatory framework.

Banking and Finance

Islamic Finance was first introduced in Maldives in 2005 through a Sri Lankan company, which began offering general insurance products based on Shariah principles. The Maldives Banking Act was passed in 2010, authorizing the MMA to issue regulations relating to the conduct of Islamic banking activities. Pursuant to this mandate, Maldives Islamic Banking Regulations were issued in 2011, which govern the “licensing, financial, prudential, supervisory matters relating to Islamic banking business in the Maldives.” In the same year, the Maldives Islamic Bank was established, the first full-fledged Islamic bank to operate in the country. In 2012, the first-ever Islamic window of a non-banking financial institution, HDFC Amna, a unit of the Maldivian Housing Finance Corp HDFC was introduced to offer musharakah-based home financing instruments. Currently, there are about 13 financial institutions offering Islamic financial services and products in the country.

To drive up the market share of Islamic finance, the government in January 2016 set up a dedicated firm, Khazana Maldives, tasked with developing Shariah finance, as well as established the Maldives Center for Islamic Finance (MCIF) with the objective of making the nation as a hub for Islamic finance and Halal industry for South Asia. The center is a 100% government owned entity, which performs a wide range of functions relating to Islamic finance, including: conducting research, providing product structuring and consultancy services, floating Islamic capital market instruments on the Maldives Stock Exchange, among many others.

* Source: State Bank of Pakistan, Quarterly Islamic Banking Bulletin July-Sept 2017
Takaful

The history of Maldives’s Islamic finance began in 2005 in the form of Amana Takaful Maldives which offered general insurance products. In 2011, the operator became the first Shariah compliant equity stock to be listed on the Maldives Stock Exchange. The Takaful sector is showing promising signs of growth as in 2014, Allied Insurance Maldives the largest local insurer launched an Islamic window, Ayady Takaful which partnered with the National Disaster Management Center in 2017 to roll out a new Takaful scheme for natural disasters.

Sukuk

Although Maldives is relatively a new entrant in the area of Islamic finance, it has successfully issued Sukuk. The Government has established a Shariah advisory board and laid the regulatory groundwork for Sukuk investment. In 2013, the first corporate Sukuk in Maldives was issued by Housing Development Finance Corporation Plc which was a 10-year corporate real estate Sukuk raising USD 3.9 million in proceeds for the issuer. This followed a private sovereign Sukuk, Wakalah/ Mudarabah facility using oil trading as an underlying asset.

Future Outlook

Recent years have seen important initial steps towards the development of Islamic finance in Maldives. The country is focusing on developing its Islamic finance talent pool; especially, it has been making collaborative efforts to attract more women into the Islamic finance industry by means of training and research among others. According to Bloomberg, the tourism-dependent island nation is looking to diversify its economy by luring Islamic debt sales and deposits from India, where there is a large Muslim population but no Sukuk or Shariah lenders.

With the promotion of Islamic economy in Maldives, not only Islamic banking and finance will grow but Halal Industry, Halal Tourism and individual power are also expected to expand. Government can get financial resources in the form of Sukuk for its various developmental plans and through Halal Tourism millions of tourists can be attracted towards Maldives. The country, however, would need to make more efforts for creating awareness about Islamic finance in masses.

Sources of Information

- Central Bank of Maldives website http://www.mma.gov.mv
- www.islamicfinancenews.com
- https://www.adb.org/sectors/finance/islamic-finance/country-profiles
- https://www.globalbankingandfinance.com/list-of-islamic-banks-in-maldives
Book Review

Title: Islam, Poverty and Income Distribution.
Author: Dr. Ziauddin Ahmad.
Publisher: The Islamic Foundation.
Reviewed by: Dr. Salman Ahmed Shaikh

Islam, Poverty and Income Distribution is a book written by an eminent scholar, Dr. Ziauddin Ahmad. The book is divided into four chapters. Chapter 1 explains Islamic vision of a just socio-economic order. The second chapter outlines the policy framework for the eradication of poverty and achievement of an equitable distribution of income and wealth. Chapter 3 provides the distinctiveness of the Islamic approach. The final chapter summarizes the main discussion and concludes.

The book emphasizes the commitment of Islam for upholding human dignity which is subdued by the presence of poverty. Prophet Muhammad (PBUH) sought refuge from the state of poverty. Islam emphasizes on the state as well as the members of the Muslim community to actively engage in feeding the hungry, spending in charitable acts and sharing the bounties of Allah with their fellow members. Islamic approach tackles the problem of poverty through its philosophy, specific teachings and institutions.

At the philosophical and behavioral level, the Islamic worldview regards wealth and resources as the trust of Allah. This encourages the cooperation, sharing and responsibility by inculcating the value of custodianship. Islamic philosophy of life prioritizes equitable distribution over Pareto efficiency. Overreliance on Pareto efficiency paralyses the equity and ethical concerns of development policy change. As per Pareto efficiency, it is inefficient to help millions of poor to make them better off while making any single rich person worse off. While Islamic principles allow freedom and liberty in lawful consumption within the moral boundaries, they induce affirmative action to promote well-being when people possess the means. In contrast, according to consumer sovereignty, as long as people can put up dollar votes for their preferences, resources will be allocated on producing, marketing and distributing inessential goods even if a quarter of world population lives in poverty and suffer from hunger, malnourishment and curable diseases.

The specific teachings of Islam encourage people to belittle their material and instinctive desires and seek contentment rather than just instinctive pleasure. Islamic teachings encourage spending on the welfare of the poor and underprivileged members of the society repeatedly. Islamic teachings encourage people to spend surplus income and
wealth to the welfare causes in a Muslim society. Thus, Islamic social framework has virtues of cooperation, solidarity and a vibrant social safety net.

At the institutional level, Islamic institution of Zakat redistributes wealth and income in the society from the rich to the poor. Zakat on wealth checks both income as well as wealth inequality. By disallowing fixed return on money capital, Islam solves the problem of income and wealth inequality by encouraging the money capital to flow in the real sectors of the economy. Thus, it encourages investments in the physical sector of the economy which directly leads to increase in employment and production. Other than Zakat, the institution of Waqf encourages perpetual charity so that it becomes a sustainable and long term source of benefit for the society. On the other hand, Islamic inheritance laws ensure that wealth circulates from generations to generations widely among the various relatives of the deceased. In this way, wealth concentration is checked in each household unit in each generation.

Interest based monetary system filters capital availability by providing it mainly to the capitalists who already possess the capital. Hence, it benefits the capitalists rather than enterprising people who have skills and determination to work and engage in productive enterprise. Increased income inequality, poverty and below full employment use of real resources results from artificially making capital scarce. Islam disregards privilege to money capital in the form of interest. It links the payoff paid to the factors of production with the outcome of the productive enterprise or productive use of real assets in a real economic activity. Resultantly, the capital circulates in the economy and gets invested rather than remaining idle since idle money capital deserves no compensation in the Islamic economic framework.

The institution of Zakat levies a special tax on cash, cash equivalents and capital in excess of need that makes sure that the money circulates and is used in the productive activities. Tax on cash and capital will force the people to invest their money in productive uses. With the prohibition of interest, this money will only go into business, either with the start of one’s own business or equity participation through Mudarabah, Musharakah and joint stock companies. Thus, Islamic teachings and institutions have substantial potential to solve the problem of poverty and income inequality within the market by influencing market dynamics as well as through the vibrant social sector institutions.
# OIC Countries Rank in World Governance Index – 2015

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>VA</th>
<th>PS</th>
<th>GE</th>
<th>RQ</th>
<th>RL</th>
<th>CC</th>
<th>WGI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>United Arab Emirates</td>
<td>-1.07</td>
<td>0.76</td>
<td>1.54</td>
<td>1.13</td>
<td>0.71</td>
<td>1.12</td>
<td>0.70</td>
</tr>
<tr>
<td>2</td>
<td>Qatar</td>
<td>-1.01</td>
<td>0.98</td>
<td>1.00</td>
<td>0.69</td>
<td>0.88</td>
<td>0.98</td>
<td>0.59</td>
</tr>
<tr>
<td>3</td>
<td>Brunei Darussalam</td>
<td>-0.79</td>
<td>1.21</td>
<td>1.05</td>
<td>0.84</td>
<td>0.44</td>
<td>0.64</td>
<td>0.57</td>
</tr>
<tr>
<td>4</td>
<td>Malaysia</td>
<td>-0.35</td>
<td>0.19</td>
<td>0.96</td>
<td>0.77</td>
<td>0.57</td>
<td>0.28</td>
<td>0.41</td>
</tr>
<tr>
<td>5</td>
<td>Oman</td>
<td>-1.03</td>
<td>0.69</td>
<td>0.09</td>
<td>0.58</td>
<td>0.46</td>
<td>0.20</td>
<td>0.17</td>
</tr>
<tr>
<td>6</td>
<td>Albania</td>
<td>0.16</td>
<td>0.36</td>
<td>0.03</td>
<td>0.20</td>
<td>-0.36</td>
<td>-0.44</td>
<td>-0.01</td>
</tr>
<tr>
<td>7</td>
<td>Bahrain</td>
<td>-1.32</td>
<td>-1.08</td>
<td>0.57</td>
<td>0.83</td>
<td>0.46</td>
<td>0.17</td>
<td>-0.06</td>
</tr>
<tr>
<td>8</td>
<td>Jordan</td>
<td>-0.78</td>
<td>-0.58</td>
<td>0.14</td>
<td>0.05</td>
<td>0.46</td>
<td>0.26</td>
<td>-0.07</td>
</tr>
<tr>
<td>9</td>
<td>Senegal</td>
<td>0.25</td>
<td>-0.17</td>
<td>-0.44</td>
<td>-0.18</td>
<td>-0.15</td>
<td>0.03</td>
<td>-0.11</td>
</tr>
<tr>
<td>10</td>
<td>Kuwait</td>
<td>-0.65</td>
<td>-0.11</td>
<td>-0.02</td>
<td>-0.16</td>
<td>0.03</td>
<td>-0.22</td>
<td>-0.19</td>
</tr>
<tr>
<td>11</td>
<td>Suriname</td>
<td>0.45</td>
<td>0.21</td>
<td>-0.36</td>
<td>-0.66</td>
<td>-0.25</td>
<td>-0.57</td>
<td>-0.20</td>
</tr>
<tr>
<td>12</td>
<td>Turkey</td>
<td>-0.37</td>
<td>-1.28</td>
<td>0.23</td>
<td>0.33</td>
<td>-0.06</td>
<td>-0.11</td>
<td>-0.21</td>
</tr>
<tr>
<td>13</td>
<td>Tunisia</td>
<td>0.19</td>
<td>-0.87</td>
<td>-0.10</td>
<td>-0.39</td>
<td>-0.05</td>
<td>-0.11</td>
<td>-0.22</td>
</tr>
<tr>
<td>14</td>
<td>Morocco</td>
<td>-0.66</td>
<td>-0.34</td>
<td>-0.06</td>
<td>-0.17</td>
<td>-0.08</td>
<td>-0.25</td>
<td>-0.26</td>
</tr>
<tr>
<td>15</td>
<td>Maldives</td>
<td>-0.50</td>
<td>0.48</td>
<td>-0.38</td>
<td>-0.42</td>
<td>-0.52</td>
<td>-0.27</td>
<td>-0.27</td>
</tr>
<tr>
<td>16</td>
<td>Saudi Arabia</td>
<td>-1.76</td>
<td>-0.54</td>
<td>0.21</td>
<td>0.03</td>
<td>0.25</td>
<td>0.06</td>
<td>-0.29</td>
</tr>
<tr>
<td>17</td>
<td>Indonesia</td>
<td>0.14</td>
<td>-0.60</td>
<td>-0.22</td>
<td>-0.21</td>
<td>-0.41</td>
<td>-0.45</td>
<td>-0.29</td>
</tr>
<tr>
<td>18</td>
<td>Bosnia and Herzegovina</td>
<td>-0.11</td>
<td>-0.45</td>
<td>-0.54</td>
<td>-0.18</td>
<td>-0.29</td>
<td>-0.37</td>
<td>-0.32</td>
</tr>
<tr>
<td>19</td>
<td>Benin</td>
<td>0.28</td>
<td>0.00</td>
<td>-0.62</td>
<td>-0.56</td>
<td>-0.58</td>
<td>-0.61</td>
<td>-0.35</td>
</tr>
<tr>
<td>20</td>
<td>Guyana</td>
<td>0.22</td>
<td>-0.18</td>
<td>-0.34</td>
<td>-0.55</td>
<td>-0.50</td>
<td>-0.77</td>
<td>-0.35</td>
</tr>
</tbody>
</table>

**Source:** World Governance Indicators, World Bank 2015

**Legends**

VA – Voice and Accountability  
PS – Political Stability  
GE – Government Effectiveness  
RQ – Regulatory Quality  
RL – Rule of Law  
CC – Control of Corruption

WGI – World Governance Index (Average Value of 6 Indicators)
Note to contributors

Journal of Islamic Banking and Finance is an official publication of International Association of Islamic Banks Karachi, Pakistan. It is a refereed quarterly journal, as well as a pioneer in the field of Islamic banking and finance being published since 1984. It provides a forum for researchers, particularly in Islamic Banking and Finance, wishing to share their expertise with a vast intelligentsia in the form of articles, research and discussion papers and book reviews. Major areas of interest for the journal include: (i) Theoretical issues in banking and financial industry specially from Islamic perspective; (ii) Empirical studies about the Islamic banking and financial institutions; (iii) Survey studies on issues in Islamic banking and finance; (iv) Analytical studies of applied Islamic banking; (v) Comparative studies on Islamic and conventional banking systems; and (vi) Short communications and interviews investigating the perceptions of leading bankers and banking experts as well as policy makers.

Articles Submission:

The contributors are requested to observe the following rules.

- Articles should be typed in M.S. Word and restricted to 10 to 15 pages of A-4 size paper. We accept original contributions only and if the material is taken from some book or any other source, the source may be mentioned. The editorial team does not assume any liability for the views of the writers expressed in their articles nor may necessarily agree with their views.

- The articles should be submitted before start of the first month of each quarter, beginning from January, April, July & October enabling review and approval of the material by the editorial board for publication in the issue in hand.

- If the editorial Board is of the opinion that the article provisionally accepted for publication needs to be revised, shortened, or the particular expressions therein need to be deleted or rephrased, such opinions will be communicated to the author for appropriate action. The author may also be requested to recast any article in response to the comments made thereon by the reviewers.

- The numbering of footnotes will be consecutive, and the footnotes themselves will be placed at the end of the article.

- The author(s) of articles published will receive 2 complimentary copies of the Journal of Islamic Banking & Finance and the IAIB reserves all rights in the material published in the Journal.
Abstract:
The articles should contain well summarized abstracts between 100 to 200 words, covering the subject matter of the articles, its conclusion and the result arrived at, with key words.

Tables and Figures:
Figures, tables and boxes should be numbered consecutively in Arabic numeral (i.e figure 1, figure 2 and Table 1 & Table 2)

Book Review:
New books (on Islamic economics, finance and banking, as well as on issues and problems of economic development) will be reviewed in the Journal on request. Authors/publishers may send two copies of each book to the editor for purpose of review. All communications should be addressed to the editor.
Journal Of
Islamic Banking and Finance

Publication Date: 1984 (Pioneer in field of Islamic Banking & Finance in Pakistan)
Frequency: Quarterly (Refereed/Peer Reviewed)
Registration: ISSN 1814-8042
Index Islamicus (Indexing/Abstracting Service)
Circulation: Worldwide include IMF, World Bank, Central Commercial Banks, Universities, Educational Institutions, and Public Libraries in Pakistan/abroad, Individuals, Scholars, Jurists etc.

Advertisement Rates (per Insertion)

<table>
<thead>
<tr>
<th></th>
<th>Pakistan</th>
<th></th>
<th>Abroad</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary Full Page (Coloured)</td>
<td>Rs. 10,000/=</td>
<td>(Minimum 3 Insertions)</td>
<td>US$. 125/=</td>
</tr>
<tr>
<td>Inside Front Cover (Coloured)</td>
<td>Rs. 12,000/=</td>
<td>Inside back Cover (Coloured)</td>
<td>US$. 18.00</td>
</tr>
<tr>
<td>Inside back Cover (Coloured)</td>
<td>Rs. 12,000/=</td>
<td>Full Page Back cover (Coloured)</td>
<td>US$. 200/=</td>
</tr>
</tbody>
</table>

Subscription Rates (Including postage)

<table>
<thead>
<tr>
<th></th>
<th>One year</th>
<th>Two years</th>
<th>Per single copy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pakistan</td>
<td>Rs. 900.00</td>
<td>Rs. 1700.00</td>
<td>Rs. 200.00</td>
</tr>
<tr>
<td>Overseas</td>
<td>US$. 75.00</td>
<td>US$. 140.00</td>
<td>US$. 18.00</td>
</tr>
</tbody>
</table>

For Students

<table>
<thead>
<tr>
<th></th>
<th>Pakistan</th>
<th>Overseas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 550.00</td>
<td>US$. 35.00</td>
<td></td>
</tr>
</tbody>
</table>

Old Issues of One Year

<table>
<thead>
<tr>
<th></th>
<th>Pakistan</th>
<th>Overseas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 500.00</td>
<td>US$. 25.00</td>
<td></td>
</tr>
</tbody>
</table>

Note: The payment be made through draft/telegraphic transfer payable in Pakistan in favour International Association of Islamic Banks.

For Further Details Please Contact:
B-5 (1st Floor), Kehkashan Apartments,
Block No. 7, Main Clifton Road,
Karachi (Pakistan)
Phone: + 92 (21) 35837315
E-Mail ia_ib@yahoo.com
www.islamicbanking.asia
Enshrined in the light of Shariah

Playing our part in the transformation of the country's financial system, in conformity with principles enshrined in the Shariah, Trust Modaraba is more than proud to be providing risk-free investment and financing opportunities for the prosperity of the nation.

Trust Modaraba is a perpetual and multi-purpose Modaraba primarily engaged in:

- IJARAH
- MUSAMMARAH
- MODARABA
- TAKHIRING

Head Office 164-220, Ground Floor, W2A Block, Citizen Housing Scheme, Karachi-75330. Tel: 021-345 55000. Fax: 021-345 55001. Email: info@trustmodaraba.com

1st Fl. 2nd Ring, Garden Heights, D-12 Block, Harr Gurdas House, Lahore. Tel: 042-357 74012. Fax: 042-357 74011.

11-A, Adjacent Central Bank, North, Faisalabad 36000. Tel: 041-357 77210. Fax: 041-357 77110.

www.trustmodaraba.com
Celebrating 15 Years
of Bringing Islamic Banking
Closer to You

As pioneers of Islamic Banking in Pakistan, we have always put the customer at the center of everything we do. We believe that making banking easier and more accessible for our customers is the key to customer satisfaction. Experience the convenience of Islamic Banking with Meezan Bank’s technologically advanced services.

For further information, please visit our website.