

ISLAMIC FINANCE

What is it all about?

HAHID B. ZAMIR

SOCIO-ECONOMIC justice is one of the most significant characteristics for social, political, economic and other realms of human interaction. The goals of socio-economic justice and equitable distribution of income and wealth are integral parts of the moral philosophy of Islam. One of the socio-economic reforms made by Islam was the prohibition of interest through the establishment of interest-free Islamic finance. In this article, I will briefly explain how an interest-free Islamic finance based on profit and loss sharing will help bring about sustainable economic growth and innovation and thereby pave the way for a prosperous world.

Saving and investment
Saving and investment are two of the most important determinants of economic growth and development. The classical belief that saving is determined by the interest rate is refuted by Keynes. According to him, aggregate saving is governed by the aggregate income. Empirical evidence does not show any significant relationship between saving and interest rates. In fact, interest puts a limit to the marginal efficiency of capital, which does not rise to its optimum level, thus all the resources available cannot be fully utilised. This causes a fall in investment.

Interest is also considered as a cost of production and hence the price of the product is adjusted to it, so consumers are affected because of the higher prices of goods and services. In fact, in an interest-free Islamic financial system, savings are likely to be promoted. First of all, in the profit sharing arrangement the return to capital will include "reward for both savings and risk-taking," which means a higher return to financiers than in an interest-based system. This means if higher returns or higher income determine the level of savings, people will save more in a share economy than in an interest based economic system.

Secondly, profit-sharing in mass production between employer and employees will, on average, give higher income to the employees who constitute the majority of the population.

On the other hand, in an interest-free scheme, where both the financiers and the investors have a stake in the return of their investments, low returns may not deter them from investing, as neither the

CONTRAST OF FINANCIAL SYSTEMS	
CONVENTIONAL FINANCE	ISLAMIC FINANCE
Interest and Interest based transactions	No Interest and Interest based transactions
Deposits and Loans	Equity shares ownership of real assets in investment projects
Banks create and destroy money	Banks do not create and destroy money
Asset-liability mismatch, illiquid	No asset-liability mismatch, liquid
Money multiplier depends on reserve ratio, very high; infinite with securitisation.	Money multiplier depends on the saving ratio, very low.
Speculation	No speculation
Interest rate not related to real economy, high price distortion.	Profit rate is determined by real economy, no price distortion
High cyclical: booms and busts, uncertainties, unpredictable growth.	Stable economic growth, predictable
Massive bankruptcies, contagion, bailouts	No systematic bankruptcies, no bailouts
Interest rate policy, highly destabilising.	No interest policy, money aggregates are used, highly stable

investors nor the financiers will be better off or worse off, one at the cost of the other. In fact, both can be worse off by not investing. In the profit sharing system, it is innovative enterprises that are likely to set constraints to investment rather than finance. This is because capital does not impose a limit to investment such as in the interest based system. Thus, innovative entrepreneurs who are ready to develop new profitable investments will always raise funds for such ventures.

Unemployment and inflation
Interest rate causes unemployment and inflation in several ways. When it is high it also makes cost of production high,

causing a decline in investment and in some cases closure of production units, resulting in retrenchment of workers. Alternatively, producers increase the prices of goods and services to cover the increased cost, thereby causing inflation. On the other hand, when interest rate is low the tendency is to switch to capital intensive method of production, thereby causing technical unemployment due to the replacement of labour by machinery.

Low interest rate encourages borrowing for consumption, which usually increases the demand for goods and services, hence resulting in demand pull inflation. Martin Weitzman has stated that all the mechanisms used in solving the problem of stagflation have failed. He

said that profit-sharing is the best form of policy for combating unemployment and inflation. He further mentioned that profit-sharing represents an easy way of building into the system the kind of natural resistance to unemployment and inflation that could really disarm stagflation at its source.

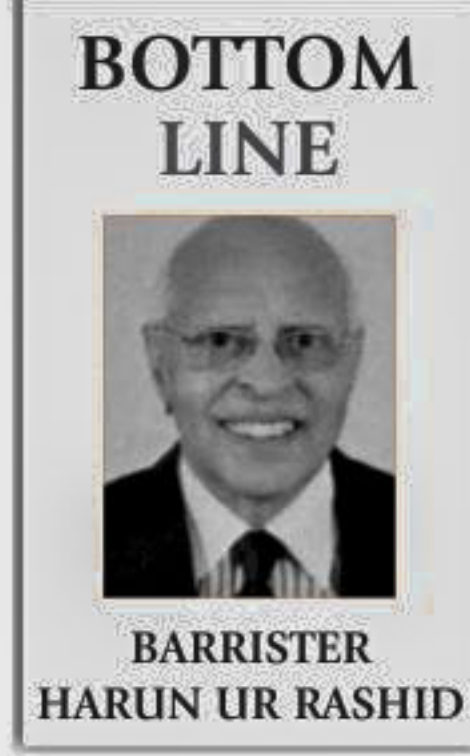
Interest and stability
It may be asserted that interest is one of the most destabilising factors in the capitalist economy. Milton Friedman, posing the question, "What accounts for this unprecedented erratic behaviour of the US economy?" responds by saying, "The answer that leaps to mind is the correspondingly erratic behaviour of interest rate." Erratic fluctuation of the rate of interest creates erratic shifts in financial resources between users, sectors of the economy and countries, causing erratic movements in the loan based investments, commodity and stock prices and exchange rates. The high degree of interest rate volatility has injected great uncertainty into the investment market, which has had the effect of driving borrowers and lenders alike from the longer end of the debt market into the shorter end, thus fundamentally altering the investment decisions of businessmen.

Islamic finance based on profit and loss sharing (PLS) is likely to be more attractive for both the firms and the financiers. This is because PLS system promises leverage benefits to the firms free of risk and a return higher than the rate of interest to the financiers. Fluctuations in the rate of profit on equity under Islamic finance are likely to be smaller than the rate of profit on equity under the interest finance and that PLS operations may have a smaller destabilising potential for the economy as a whole compared to financing on interest. Another factor that makes Islamic finance more profitable than interest-based system is that the burden of the risks on the part of the investors is reduced. This encourages entrepreneurs to be more innovative and venture into high risk projects which are usually characterised by high profitability. Furthermore, the spirit of mutual co-operation and sense of ownership and responsibility promoted by profit-sharing results in efficient use of resources and increased output in turn increases profit.

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TALIBAN AND ISIS

The difference



BOTTOM LINE
BARRISTER HARUN UR RASHID

RECENTLY, White House Press Secretary Josh Earnest said that the Taliban was an "armed insurgency" rather than a terrorist group. The press secretary realised that given the record of the Taliban, especially Pakistani-based Taliban, which committed the heinous attack on the elementary school in Peshawar and carried out another attack on an Ahmadaya mosque in Karachi, it was a grave mistake. He reportedly stated later that the Treasury Department had put the Taliban on a terror list back in 2002.

According to analysts, there are five critical differences between al-Qaeda and the new threat of ISIS. First, ISIS is fighting more like a conventional army than al-Qaeda ever did. It has seized a large territory in northern Syria and Iraq and declared a caliphate there. ISIS is also employing more conventional military tactics, using assault rifles and grenades. Al-Qaeda has not sought to hold on to territory as much as it has been focused on carrying out spectacular attacks that would grab attention of international media.

Second, ISIS is even more brutal than al-Qaeda. It has used extreme violence and brutality to attract attention and more followers and, so far, experts say it is working. "They attract disaffected young people that want to kill other people," said Clint Watts, senior fellow at George Washington University's Homeland Security Policy Institute and senior fellow at the Foreign Policy Research Institute. ISIS has gained international attention by beheading prisoners and enemies, and then posting pictures of the violence on social media. It even burned alive a Jordanian pilot, who was a Sunni Muslim.

Al-Qaeda, in contrast, has shunned that practice because it risks turning off less extreme Sunnis and other Muslims from sympathising with their cause.

Third, ISIS is more popular with young people. It now has more followers than al-Qaeda because of the recruitment boom in Syria. ISIS has also attracted followers because it aims for an Islamic state, and has territory to show for it. It has also gained popularity with the young by embracing social media, while al-Qaeda is stuck to more traditional recruiting methods. ISIS has really grown in popularity because it wants an Islamic State.

Finland, Ireland and Australia reportedly have the highest number of foreign fighters per capita, although Finnish security officials say some Finns in their count went for humanitarian reasons. Intelligence officials say there are more than 30,000 ISIS followers, while experts believe al-Qaeda's formal membership is much smaller. Al-Qaeda has also suffered heavy losses from defection or destruction.

Fourth, Al-Qaeda has attacked the US. ISIS has not, though it has made it clear that it wants to do so. For that reason, al-Qaeda is still considered the recognised leader of the global jihadist movement. Since the 9/11 attack, al-Qaeda has carried out plots against the US several times over the last five years, and the group has the capability to do more.

Finally, ISIS is the richer organisation and its funding comes from a variety of sources. Computer disks taken from an ISIS courier by Iraqi forces before the fall of the northern city of Mosul reportedly revealed that ISIS -- before the city's capture -- had cash and assets worth \$875 million (£516 million). After the fall of Mosul, ISIS looted the banks and captured military supplies that have boosted the group's coffers to about \$2 billion, according to Iraqi officials.

The oil comes from wells and refineries that ISIS has taken over inside northern Iraq and northern Syria, and until very recently it was reportedly easy to smuggle it into other countries at a very cheap price. One reason is that cheap, smuggled oil is a much-prized commodity where oil is so expensive that it almost doesn't matter who is selling it.

Besides revenue from oil smuggling, the group receives money through donations from wealthy sympathisers in many Arab countries.

ISIS demands money from people wherever it has established control. Villagers in ISIS territory are reportedly charged, and pay for just about everything. Another funding source is ransom for freeing hostages.

"ISIS now presents itself as an ideologically superior alternative to al-Qaeda within the jihadi community," says Charles Lister, of the Brookings Doha Center. "As such, it has increasingly become a transnational movement with immediate objectives far beyond Iraq and Syria."

Australian Foreign Minister Julie Bishop warned that ISIS was extending its influence into Afghanistan, according to AFP. If the news is correct, then it may gradually attempt to influence the South Asian countries.

The writer is former Bangladesh Ambassador to the UN, Geneva.

Undefined blockade and unanswered questions

ABDUL MATIN

THE 20-party alliance imposed an indefinite blockade from January 6. In an earlier article (DS January 9, 2014) I mentioned that blockades are imposed only during wars. For example, during our War of Independence in 1971, India blocked supplies of arms and ammunition to the Pakistani forces in Bangladesh. Consequently, the Pakistan armed forces were forced to surrender on December 16, 1971 with the emergence of Bangladesh as an independent state. People in Bangladesh and around the world are confused to see that an indefinite blockade has been imposed by a political alliance in order to topple the government. Nobody understands what this blockade means. What are the people supposed to do and not do during blockades? Are they supposed to stop going to work, or sending kids to school, or buying food or

getting medical care for an indefinite period?

Occasionally, the leader of the 20-party alliance advises her party workers to intensify the movement without causing inconvenience to the people but does not illustrate how to do it. She also advises the people to make 'small sacrifices' for the 'greater interest of the country.' Under compulsion, people do go out defying the blockade. Consequently, more than 50 people have been killed and over 1,000 injured since the blockade started. Forty one vehicles have been torched and seven trains derailed. Ten launches were sabotaged. There is no new investment. The job market is shrinking. Farmers are unable to market their products. Without education, the academic careers of a whole generation are in jeopardy. How can a nation survive if a generation remains ill-educated? Do all these constitute a small sacrifice? What greater interests of the country will be served by shutting down businesses, facto-

ries, schools, exports and imports? Who can avert a large-scale famine in the country if production of food falls drastically due to shortage of fertilizers, diesel and seeds and we are unable to import food because of financial constraints and indefinite blockade? Who will take responsibility for the famine and the resulting deaths?

The opposition alliance denies that their workers are involved in arson and sabotage and the government agents are causing all the mischief only to put the blame on the opposition. In that case, why do they not cooperate with the police to nab the miscreants and thus expose the ill-motives of the government?

The government claims that things are normal and the law-enforcing agencies are enough to bring the situation under control. In that case, why is it taking so long to restore normalcy? If the number of miscreants is very small, as claimed by the government, why are they not caught

and given exemplary punishment? Why has the government failed to provide security to the lives and properties of the people? Is it not the prime responsibility of the government?

The people are not participants in this movement. They are the victims. Without their participation, the movement is bound to die down, sooner or later, like it did last year, but it will cause irreparable damage to the country. If it continues and the government is toppled, a new election is held, the 14-party alliance does not take part in the election under any pretext, the 20-party alliance forms a new government and the 14-party alliance imposes another indefinite blockade from day one, what will be our fate? Shall we not go back to square one and face a new wave of violence? In that case, should violence be allowed to succeed?

The writer is a senior nuclear engineer.

CROSSWORD by Thomas Joseph

ACROSS

- Winter quaff
- Significant
- Mystiques
- "-of Two Cities"
- Long-legged bird
- Forays
- Lobbying org.
- Cart puller
- Tell tales
- Sense of self
- Ultimate
- Farm female
- Lessen
- In need of directions
- Words after "peekaboo"
- "The Phantom Tollbooth" boy
- Deputized groups
- Try out
- Winter bug
- Work phone No.
- Polite address
- Writer Deighton
- Letter after pi
- Bumer setting
- Pun response

DOWN

- Game leader
- Cry of surrender
- Hockey feints
- Bare
- Cartoon ghost
- Power problem
- #1 hit for Elton
- Lifeboat need
- Crooked
- Coot's home
- loss
- #1 hit for Elvis
- Nostalgic songs
- Bristle at
- Chapel feature
- Glentertainers
- Alamos
- Tot
- Disordered
- "Am I crazy?"
- Let it out
- Doped up
- High-tails it
- Geese formation
- Gene messenger



QUOTABLE Quote

We cannot live only for ourselves. A thousand fibers connect us with our fellow men.

Herman Melville

Yesterday's answer

P I N T A J A F A R
I L I A D E M I L Y
E L C I D T I T L E
E L E C T S
S A N D R Y W E D
P R E S T O H A L O
Y E L L O W B E L L Y
O N L Y B O W T I E
N A Y T A N K E N
P A R A D E
I N B O X N Y L O N
C O U P E Z E L D A
E D G E S A S Y E T

BEETLE BAILEY

by Mort Walker



CRYPTOQUOTE

TML ORM TUUD QRMIWP, QRX RIZ ARIRM', QXRMRM QRML, TML TUU IXW UTML QRJU AW ETMIUWL QRX ZMVQ.

— PVD AWTM

Yesterday's Cryptoquote: CHRISTMAS, MY CHILD, IS LOVE IN ACTION, EVERY TIME WE LOVE, EVERY TIME WE GIVE, IT'S CHRISTMAS.

— DALE EVANS ROGERS

A XYDLBAAXR is LONGFELLOW

One letter stands for another. In this sample, A is used for the three L's, X for the two O's, etc. Single letters, apostrophes, the length and formation of the words are all hints. Each day the code letters are different.