

CHAPTER 14

ECONOMIC SYSTEM OF ISLAM

14.1 Definition of Islamic Economic System

Islam is a complete code of life, based on natural instincts. It endorses us moderate economic system, as compared to other economic systems. It is based on moral values such as sympathy, brotherhood, justice, moderation and fair means of earning.

Islamic economic system is a set of principles, derived from the Holy Quran and Sunnah, relating to satisfy economic needs of people living in an organized society. Under Islamic economic principles, justice and moderation are basic elements to regulate wealth's production, consumption, distribution and exchange. Hence, Islamic economic system neither permits concentration of wealth like in capitalism; nor it allows state to own all resources, like in socialism. In fact, Islamic economic system is a moderate way between these two extremes.

14.2 CHARACTERISTICS OF ISLAMIC ECONOMIC SYSTEM

Following are the important characteristics of Islamic economic system:

1) **Optimum Utilization of Natural Resources**

Islamic economic system teaches us to get maximum benefits from the unlimited natural resources, such as minerals, forests, rivers, seas, mountains, fields etc. It urges mankind to make full use of these natural resources, through innovations and developments. Islam dislikes non-utilization, and therefore wastage, of these natural resources. It is the Islamic way of life that provides incentive to human-beings for innovations, research and development activities so that natural resources could be exploited to the maximum extent. Islamic economic system guarantees access of all mankind to all natural resources. Therefore, best utilization of natural resources causes increase in national wealth and production.

2) **Right of Ownership**

Allah is the creator and absolute Owner of each and every item of the universe. Allah also made the human being his Caliph on the Earth. Allah made him custodian of the resources of the universe. Islam recognizes right of personal ownership of property owned through fair means and not through exploitation or unfair means. Islam allows a person to use his wealth whatever righteous way he likes. It may be for one's personal/private consumption or to further generate his wealth. Islam, is, however, against undue concentration of wealth and stressed upon looking after the poor and the needy people by wealthy segment of the society.

3) **Economic Freedom**

Islamic economic system guarantees the availability of equal opportunity to all for fairly earning of livelihood. People are expected to earn their income by

observing religious limitations and legal restrictions imposed by the Islamic state. Islam strictly prohibits earning of wealth using illegal ways or means declared unfair (Haram) by Islam; for instance, income earned through smuggling, hoarding, bribery and mean practices etc. It should be clearly understood that Islam's economic freedom permits people to earn income by using fair (Halal) means, as allowed by Islam. It also stresses putting their earnings to religiously legitimate usage.

4) Fair Distribution of Wealth

Islam gives special emphasis on fair distribution of wealth. On the one hand, Islam allows people to acquire wealth by using fair means and, on the other hand, it makes resourceful community responsible to take care of poor and needy people. Islam strictly orders for regular payment of Zakat and Usher and presses for frequent giveaways and Sadkat etc. In this way, Islam ensures fair distribution of wealth in the Society rather than its concentration into a few hands.

5) Circulation of Wealth

Islamic economic system is grossly against the concentration of wealth into a few hands and introduces Zakat as an effective tool to maintain flow of wealth from the rich to the poor. Islam encourages the use of wealth for personal comforts/needs and, equally, for caring the poor/needy. Islam has devised a system for annual distribution of wealth of the rich among eligible poor community in the form of Zakat. It increases purchasing power of the poor which raises consumption of goods and services. It, thus, stimulates investment in an Islamic economy.

6) Social Welfare

Islamic economic system gives great emphasis on social welfare of the people at large. Bait-ul-Mal helps the poor/destitute to ensure their access to basic amenities of life. Zakat inculcates feelings of brotherhood. Islam has banned all social evils and bad habits such as use of narcotics, keeping illegitimate relationship and gambling etc. Islamic economic system, therefore, assists in promoting a society free from evils.

7) Automatic System

New institutions and practices are established in an Islamic economic system. It sets free the people to take benefits of expertise/ideas of others to produce, consume and distribute wealth. It ensures operations of Islamic economy in an organized manner. Islamic economic system strictly prohibits unfair profiteering through hoarding or other un-permitted means and, therefore, brings all economic variables under direct control of forces of demand and supply. In this manner, it ensures automatic determination of price level, free from any exploitation.

8) Prohibition of Interest

Interest is very strictly prohibited in Islam. It emphasizes on interest free banking transactions such as 'Modaraba'. Under Modaraba, one invests its capital and the other person contributes his professional expertise and the profit/loss of the

ventures is shared in predetermined agreed ratio. Islam, therefore, promotes an economically neat and clean society which is free from exploitation.

9) **Positive Role of State**

Islamic economic system is actually based on principles of freedom and justice for all. Under this system, State is responsible to provide the people with basic needs of life and to take necessary measures to eliminate unemployment and poverty. It corrects economic defects by use of free play of market forces for price determination and provides equal investment opportunities to all factors/sectors of the economy. Islamic economic system, therefore, should not be considered as a set of new ideas or practices but a name of guarantee for social welfare and economic development.

Role of Zakat, Usher and Charity in Poverty Alleviation and the Provisions of Employment

Islamic economic system has provided a permanent solution for poverty alleviation. Before discussing the role of Zakat, Usher and charity in poverty alleviation and the provisions of employment, it is necessary to understand meanings of these terms:

14.3 Concept of Zakat

Literary meanings of Zakat are 'Purity and Growth'. 'Purity' refers to the cleanliness of (halal) wealth and 'Growth' means increase in purified (halal) wealth.

Zakat is obligatory in Islam. Zakat is a defined sum of money which a wealthy person (Saheb-e-Nisab) pays to the eligible poor and the needy people. Zakat is one of the five basic commandants of Islam, which every Muslim has to comply with. Payment of Zakat brings about prosperity in the wealth of the payer.

Muslim's duties towards Allah and Allah's creature (the people) have been narrated, side by side, on many places in the Holy Quran. In other words, the Holy Quran stresses upon the Zakat equally as it does of 'Salat'. Verse 42 of Surah 'Al-Bakarah' of the Holy Quran recites:

“Establish worship, give zakat and bow down your heads with those who bow down (in worship)”.

It is believed that if Zakat is fairly paid in a society, it shall end the poverty in a short period of time and promote brotherhood. It shall also accelerate economic growth and bring general prosperity.

14.4 Concept of Usher

Generally, Ushr means Zakat on agriculture produce, which is paid by the land-owners to the poor. Ushr is paid at the rate of 10% of the value of agriculture produce. Usher is paid in compliance of the Allah's orders.

14.5 Concept of Charity

Islam gives right of ownership of wealth to the people, as well as fixes certain responsibilities on the rich and well-to-do community of the Islamic society.

These responsibilities include helping the poor voluntarily, in addition to the payment of Zakat and Usher. Thus Islam encourages voluntarily spending by the rich to help the poor. This voluntary distribution of wealth among the needy people is termed as '*infaq fee sabel lillah*'.

Verse 92 surah 'Al-Imran' of the Holy Quran recites:

“By means shall you attain righteousness unless you give (freely) of that which you love. And whatever you give, Allah knoweth it well”.

Charity basically aims at reducing concentration of wealth, increasing circulation of wealth and minimizing the social difference between the haves (the rich) and the have-nots (the poor). It is purely a voluntary activity to provide livelihood to the poor. It raises standard of living of the poor that ultimately pushes the society on the path of economic development.

Role of Zakat, Ushr and Charity

Zakat is one of the basic five commandments of Islam. Zakat, Usher and charity plays an important supportive role in maintaining social justice in the Islamic society. Thus, Zakat, Usher and charity are not only an individual's activity but is also a collective duty. These tools discourage social inequality and therefore help in promoting feelings of peace, love, brotherhood and prosperity. Islam stresses on circulation of wealth instead of its concentration in a few hands. It stimulates process of production and consumption of wealth.

Following highlights the importance of Zakat, Usher and Charity as effective instruments of social and economic justice in Islam:

(1) Poverty Alleviation

Economic systems, other than Islamic, prefer growth of capital over growth and welfare of the Society. Particularly, Capitalism does not take responsibility to support the poor, the elderly, the needy, the under-debt and unemployed people. Therefore, such people live below-the poverty line. Contrary to this, Zakat, Ushr and charity ensures economic prosperity of all deprived segments of the society and alleviates poverty. In brief, individual and collective welfare is the corner-stone of the Islamic economic system.

(2) Solution for Unemployment

Zakat, Ushr and charity discourages hoarding/concentration of wealth in few hands and Islam, therefore, requires transfer (a part of wealth) from the rich to the poor. This activity increases aggregate demand, which stimulates output level. Additional output is produced to meet increased demand. Rise production level requires more labour input, which promotes employment opportunities. In this way, Islamic tools of Zakat, Usher and charity provides vast opportunities to the people to improve their income level by using their mental and physical abilities and reduces unemployment.

(3) **Expansion of Economy**

Many people tend to hoard their wealth instead of using those in business. However, Islam provides its solution in form of Zakat which has to be paid on unused/surplus wealth. Obviously, any amount of wealth is bound to come to an end if it is not used in business activities. Therefore, wealth is invested in business activities and it brings about expansion and growth in the economy. Ultimately, it results in alleviation of poverty and reduction in unemployment.

(4) **Fair Distribution of Wealth**

In present days, our society is confronted with the major issue of unequal distribution of wealth. This issue has divided the society into two classes; haves (the rich) and have-nots (the poor). The rich are living in a very luxurious way, whereas miserable life is the fate of the poor. This unequal distribution of wealth is the root cause of feelings of hatred and malice among the poor and the rich. Islam, however, provides a practical solution of this issue in form of Zakat, Usher and charity. Every Muslim, having wealth exceeding a defined limit, has to pay Zakat to the deserving people. In this way, the poor also get their share in income/wealth. It alleviates poverty and promotes employment.

(5) **Brotherhood and Cooperation**

Zakat, Ushr and charity helps in promoting atmosphere of brotherhood, unity and peace. The mechanism of transferring of wealth from the rich to the poor fosters and boosts the love and respect of the rich in the eyes of the poor. In this way, the whole society lives in harmony and peace. There are very few crimes in an Islamic society since the people are employed and have basic necessities of life.

Instruments of Zakat, Usher and charity increase purchasing power of the poor through redistribution of income/wealth, which rises aggregate demand. It, in turn, increases output/production to meet additional demand which generates more employment opportunities. High employment level increases national income which ultimately results in economic growth and development of the economy.

Exercise

Q.1: Each statement has four possible options. Tick (✓) the best one:

1. In which system, rights of private ownership have been given to the human being as a Caliph?
 - a. Capitalism
 - b. Socialism
 - c. Islamism
 - d. Mixed system
2. Which system is based on the principles of moderation?
 - a. Capitalism
 - b. Socialism
 - c. Islam
 - d. Mixed system

- Q. 2: Complete the following statements by filling in the missing words or phrases:
1. Islamic economic system is based on banking system.
 2. of wealth is prohibited in Islamic economic system.
 3. Literary meanings of are growth and purification of wealth.
 4. Zakat is a religious duty of each Muslim.
 5. Literary meanings of Usher are

- Q. 3: Match the statement in column A with the statement in column B; choose the answer from column B to write in column C:

A	B	C
Islamic economic system	Religious financial duty	
Rate of Zakat	Purification and growth	
Zakat	Complete code of life	
Meanings of Zakat	2.5 percent	
Purpose of Zakat	Circulation of wealth	

- Q. 4: Answer the following questions in three sentences:

1. What is meant by Zakat?
2. Write five characteristics of Islamic economic system.
3. Why it is said that Islamic economic system is moderate?
4. How are poverty and unemployment alleviated by Zakat?

- Q. 5: Answer the following questions in detail:

1. What is meant by Islamic Economic system?
2. Write down salient features of Islamic economic system?
3. What is Zakat and who can be the recipient of Zakat?
4. How can the issue of unemployment be resolved through Zakat, Usher and charity in a Muslim state?

ANSWERS TO OBJECTIVE QUESTIONS

CHAPTER 1 INTRODUCTION TO ECONOMICS

- Q. 1: (1) d (2) c (3) d (4) c (5) d
Q. 2: (1) Scarc (2) Alfred Marshall (3) Alternative.
(4) Adam Smith. (5) Wealth
Q. 3: Column 'C'
(1) Scarcity, is less than required
(2) Material welfare's, measurement is not possible.
Micro-economics deals with, the study of an individual of a firm.
(3) Macro-economics deals, with, the study of economic aggregates as a whole.
(4) Social science deals with the study of human behaviour.

CHAPTER 2 SUBJECT MATTER OF ECONOMICS

- Q.1: (1) c (2) c (3) d (4) b (5) c
Q.2: (1) falls (2) struggles (3) demand
(4) necessary (5) derived
Q.3: Column 'C'
(1) For economic goods, money is spent.
(2) For non-economic goods, money is not needed.
(3) For goods and services, expenditures are undertaken.
(4) For consumers' goods, producer goods are needed.
(5) For demand of a good, it must have a feature of satisfaction.

CHAPTER 3 DEMAND

- Q.1: (1) a (2) a (3) d (4) c
Q.2: (1) increases (2) demand (3) increases (4) elasticity
Q.3: Column 'C'
(1) Complementary good: An increase in the price of one good decreases the demand for the other good.
(2) Inferior good is a good whose quantity demanded decreases with a decrease in price.
(3) Normal good: A decrease in the price of a good increases the quantity demanded.
(4) Scarc good is a good whose quantity demanded increases with an increase in price.
(5) Substitute good: an increase in the price of a good increases the demand of another good.

CHAPTER 4 SUPPLY

- Q.1: (1) c (2) b (3) b (4) b (5) b
Q.2: (1) is reduced (2) positive (3) stock (4) function (5) increases
Q.3: Column 'C'
(1) Elasticity of supply: Change in quantity supplied due to a change in price.
(2) If price is higher, then produces increases supply.
(3) Tax on goods: reduces the quantity supplied.
(4) More elastic supply: Small change in price but significant change in quantity supplied.
(5) Less elastic supply: Large change in price but small change in quantity supplied.

CHAPTER 5 EQUILIBRIUM AND PRICE DETERMINATION

- Q.1: (1) d (2) d (3) d
Q.2: (1) equilibrium (2) supply (3) equilibrium price
(4) individual action (5) negative slope
Q.3: Column 'C'
(1) Market: A place where sellers and buyers are present.
(2) Perfect Competition: Where no one can fix price with individual action.
(3) Equilibrium price: Where supply and demand are equal.
(4) Demand curve: Negative slope.
(5) Supply Curve: Positive slope.

CHAPTER 6 MARKET AND PRODUCTION

- Q.1: (1) d (2) d (3) c (4) d
Q.2: (1) variable (2) inelastic (3) long run (4) supply (5) income
Q.3: Column 'C'
(1) In imperfect market, prices of goods are different.
(2) In long run market, land is a variable factor of production.
(3) In daily market, price changes daily.
(4) In perfect market, there is a rule of one price.
(5) In short run market, land is fixed factor of production.

CHAPTER 7 ECONOMIC PROBLEMS OF PAKISTAN AND THEIR REMEDIAL MEASURES

- Q.1: (1) 66 (2) 1658.36 (3) 2.4% (4) 19% (5) 231.4
Q.2: (1) under developed (2) per person (3) 2.2 (4) 63% (5) 20

- Q.3: Column 'C'
- (1) Agriculture sector contribution to GDP is 19.1%.
 - (2) Rate of industrial development is 21.02%.
 - (3) Rate of population growth is 2.4%.
 - (4) In 2021-22, literacy rate was 58.9%.
 - (5) Share of expenditure on education in total national income is 2.2%.

CHAPTER 8 BASIC CONCEPTS OF NATIONAL INCOME

- Q.1: (1) a (2) a (3) c (4) d (5) c
- Q.2: (1) total population (2) money value
 (3) per capita income (4) transfer payments
 (5) depreciation allowance
- Q.3: Column 'C'
- (1) Reward of physical and mental labour is: income
 - (2) Per capita income is = $\frac{\text{Total national income}}{\text{Total population}}$
 - (3) Subsidies are: government allowances.
 - (4) Transfer payments are Zakat and gifts etc.
 - (5) Services without payments are like: ironing one's own clothes.

CHAPTER 9 MONEY

- Q.1: (1) d (2) b (3) b (4) a (5) b
- Q.2: (1) barter system (2) standard money (3) credit money
 (4) Taken money (5) falls
- Q. 3: Column 'C'
- (1) Postal certificates: are near money.
 - (2) Fiat money: is legal tender.
 - (3) Source of transaction of good: is medium of exchange.
 - (4) Purchasing power of money means: value of money.
 - (5) Easy transfer of wealth means: easy transfer of place.

CHAPTER 10 BANKS

- Q.1: (1) b (2) d (3) b
- Q.2: (1) bank rate (2) proportional reserve (3) 1981
 (4) modaraba (5) monopoly
- Q.3: Column 'C'
- (1) Fixed fiduciary system - inelastic
 - (2) Under central bank -scheduled banks
 - (3) Deflation - decrease in purchasing power

CHAPTER 14 ECONOMIC SYSTEM OF ISLAM

- Q.1: (1) c (2) c
- Q.2: (1) interest free (2) concentration (3) zakat
(4) sahib-e-nisab (5) 10%
- Q.3: Column 'C'
- (1) Islamic economic system - complete code of life
 - (2) Rate of zakat - 2.5%
 - (3) Zakat - religious financial duty
 - (4) Meanings of zakat - purification and growth
 - (5) Purpose of zakat - circulation of wealth

GLOSSARY

- Assets:** The goods which have some monetary value and are owned by an individual or institution, for instance car, real estate property, gold etc.
- Autonomous Investment:** Autonomous investment is motivated by service motives and is independent of margin of profit. It is income inelastic and as such, it is not influenced by variation in income. Since it is not profit oriented, it remains unaffected by the variation in income, price, wage, rent, etc.
- Capital Formation:** It is accumulation of or increase in capital of an economy during a particular period of time; for instance increase in industries, roads, dams, capital goods and tools etc during a specific period of time.
- Capital Goods:** The goods which do not directly satisfy human wants but help in production of goods required for satisfying human needs. Examples of such goods are machinery, buses/trucks, tools etc.
- Consumer:** Everyone who satisfies his wants by consuming goods and services is called consumer of those goods/services.
- Consumers' Goods:** The goods that directly satisfy human wants, such as food, clothing etc.
- Consumption:** An act of getting direct satisfaction by using goods and services is termed consumption. For example, satisfying hunger by eating food, acquiring education from a teacher etc.
- Credit Money:** It refers to the credibility and trust that a lender has in borrower that lender shall fulfill his obligation to repay the amount of credit on promised date.
- Deficit Budget:** A budget where government revenue falls short to meet its expenditure.

Derived Demand: Indirect demand of a factor of production is called derived demand, for example demand for service of labourer to build a house. Likewise, an increase in demand for goods brings about an increase in demand for labourer.

Economic Structure: Detailed explanation of an economic term, in relation to specific circumstances of an economy.

Equilibrium: A situation where various economic factors do not exhibit any tendency to change.

Factors of Production: Inputs used for production of goods and services are called factors of production. There are four factors of production which include capital, labour, land, and organization.

Fiscal Policy: Policy adopted by the government for raising its income and finances to meet its expenditure is called fiscal policy.

Function: The relationship between variable and variable factors is termed as 'function'. For example, quantity demanded is a function of price; a change in price shall bring about a change in quantity of that commodity.

Goods: The things which have utility are called goods. For instance, cloth, shelter, fruits, bread, pen etc.

Hoarding: Savings which temporarily remain unutilized and not invested.

Hundi: A document signed by a businessman at the time of purchasing goods on credit. The document acts as a security in favour of seller and contains terms and conditions relating to the transactions.

Increasing: When two variables move in the same direction, upward or downward, they are called having increasing relationship between themselves. For instance, increase in price of a commodity stimulates rise in its supply.

Induced Investment: The investment which is motivated by the margin of profit, i.e., the higher the margin of profit is, the larger the volume of investment. Since margin of profit depends on the size of income and as such, induced investment is income elastic. It means that as the income rises the investment also rises and vice versa.

Inflation: A continuous rise in price level is called inflation. Its main cause is increase in supply of money without corresponding rise in supply/production of goods.

Investments: Using the saved resources in productive activities to generate more income is called investment.

Invisible Goods: Intangible items movement or flow of which could not be physically checked. Invisible goods normally refer to services, such as shipping, communication, banking, insurance etc.

Joint Stock Company: A business venture the capital for which is contributed by a number of persons. Its shareholders could sell its shares in the stock/shares market.

Market Price: It refers to a temporary equilibrium of demand and supply of a particular commodity at a given day/time. It may keep on changing due to rise/fall in demand and supply of a particular commodity.

Material Requisites: The goods and services which can not be purchased without money, such as food, cloth, house, etc.

Monetary Policy: Monetary policy is a tool used by the central bank or the government in order to achieve specific targets, by increasing or decreasing the money supply.

Money Market: Money market generally is a market where there is buying and selling of short term liquid debt instruments. Financial instruments traded in money markets are short term bonds of the Government of Pakistan

(Federal Investment Bonds, Treasury Bills), Private sector corporate bonds, debentures are called money etc.

Nationalization: The act of the Government to own privately owned organizations and put them under its direct control is known as 'nationalization'.

Perfect Competition: It refers to a situation where a number of sellers and buyers are present in the market to transact a particular commodity at the same price.

Protection: It means government policies and actions to protect domestic industries/producers from tough competition that such industries/producers have to face if foreign firms are allowed to sell their products in the home market. For example, imposition of heavy import duty on import or providing subsidy to local producers shall make imported commodities costly as compared to locally produced goods.

Raw Material: Basic material used in production of consumable goods and commodities is called raw material. Examples of raw material are cotton used for production of cloth, sugarcane/beet for sugar, oil seed for ghee/cooking oil, animal skins/hides for leather-wears etc.

Reserve Capital: The money which commercial banks are legally bound to keep with the central bank is called reserve capital. The central bank keeps on changing this reserve capital ratio to respond money demand in the market and to achieve its goals.

Saving: It is that part of one's income which he does not spend but saves it for his future needs.

Scarcity: A good which has lesser supply than its demand and has a price is called 'a scare good'. For instance food, cloth etc; which are not free gift of nature like air, sunlight etc.

- Securities:** Documents issued to lenders at the time of their lending money to the Government or other organizations. Such documents stipulate terms and conditions governing the lending of money.
- Services:** It refers to intangible/non-material goods which satisfy human wants, for example services of doctor for healthcare, services of teachers for education, services of police for law and order etc.
- Surplus Budget:** A budget where government revenue exceeds its expenditure.
- Terms of Trade:** The rate at which goods are transacted in the international market is called 'terms of trade'.
The money sent to home-country from abroad in return to export of commodities or providing services. It refers to amount with the government in form of currencies of various countries.
- Undistributed Profit:** That part of profit of an organization which is not distributed among its shareholders but is retained in the business.
- Unlimited Wants:** This term means numerous desires of human being, such as food, clothing, shelter, car etc, which have no ends. Human being dies while struggling to satisfy those unlimited desires.
- Utility:** It is a measure of satisfaction. The amount of satisfaction a person derives from consumption of goods or service. For example, bread satisfies hunger and water satisfies thirst.
- Visible Goods:** Goods which exist physically, such as buildings, food, clothes etc. Flow/movement of such goods can be recorded at each stage of their transaction.
- Wealth:** Goods and commodities possessing certain value and are comparatively scarce in supply as compared to their demand, for instance gold, cash, car, real estate property etc.

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