

TRANSITION TO A **RIBA** FREE ECONOMY



WAQAR MASOOD KHAN

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2 | Transition to the New System

Keeping in view the basic elements of the Islamic finance, we may proceed to examine each of the above transactions and see whether the *Shari'ah*-compliant methods will afford a smooth transformation that avoids any major disruptions in the working of the financial system. Our approach is to broadly specify the nature of these transactions and then indicate whether they would be amenable to reform in the light of the principles elaborated above.

Private Domestic Transactions

There is a unanimity of views amongst those who have worked in this area, that this segment of the market is the easiest to admit a smooth transition. The scope of Islamic financing methods is broad enough to meet the entire needs of this segment, at least so far as the focus of such transactions is on the productive side of business.

Liabilities Side

To start off, consider the elements of a typical balance sheet of a bank or financial institution given in the following table.

with the requirements of the *Shari'ah*. Thus it is possible, and also advisable, not only to reform the future transactions but also to convert the existing contracts in such manner that they become consistent with the *Shari'ah*.

Government Finances

Undoubtedly, the most difficult adjustment problems will be posed by the requirement of reforming the Government finances, not because of their inherent complexity, but because of rampant fiscal indiscipline that has become the hallmark of the country's fiscal management, particularly during the last one decade or so. Nothing short of a basic restructuring of the country's fiscal system will be needed in order to be effective. This is required any way, and not simply as a part of the process of eliminating *riba* from the economy.

The Government finances, in their present form, will not be amenable to adjustment in the *Shari'ah*-compliant form. The state of fiscal affairs obtaining in the country is such that very little of the Government's borrowings can be covered under this principle. At a time when the Government's income from tax and non-tax revenues is barely sufficient to meet non-interest expenditure, almost the entire borrowings are undertaken to make the interest payments.¹⁰ Obviously, no

¹⁰This is the definition of primary deficit, which is the difference between Government revenues and non-interest expenditure (i.e., expenditure other than interest payments). Economists use this measure to ascertain whether the level of public debt, and the consequent servicing liabilities, are sustainable or not. As long as the primary deficit is positive (i.e., the revenues are greater than non-interest expenditure), then the excess can be used to defray part of the interest payment and all of them will not be translated in additional borrowings. In the alternative, the entire interest payments will have to be financed through borrowings, which would unleash an explosive cycle of debt accumulation as interest payments would continuously be rising requiring greater borrowing, which in turn will further raise the required payments, with another round of still higher

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Elimination of Ribā has been a major issue in Pakistan occupying the attention of policy makers, bankers, legal experts and Islamic scholars for the last several decades. Apart from the efforts undertaken by the government to introduce non-interest modes of financing, the debate received fresh impetus after the judgment of the Federal Shariat Court in 1991 which was further reinforced by the judgment of the Supreme Court in December 1999. The present work is the outcome of the submissions that the author made before the Supreme Court when he was invited by the Court as *amicus curiae*.

Having expounded the basic principles of Islamic finance, the book traces the main challenges in various spheres of financial transactions and argues that a smooth transition to the new system is feasible. However, it cautions that in view of the pervasiveness of Ribā in modern economies and in numerous laws, merely striking down certain impugned provisions of law may not be the most desirable course. Rather, the government will have to expend a comprehensive effort through a legislative initiative to provide for an alternative system. The book also reviews the constitutional provisions relating to government's finances and identifies areas of concern that have implications for efficient fiscal management as well as for effective elimination of Ribā.

About the Author

Waqar Masood Khan, presently Secretary, Economic Affairs Division, Government of Pakistan, holds a Ph.D in Economics from Boston University. Waqar Masood Khan's concern with the operationalization of an interest-free economy goes back to the days of his graduate studies when he wrote his Ph.D thesis on the subject, later published under the title *Towards an Interest-Free Economic System* (1985). He was also a member of the Commission for Islamization of Economy, Government of Pakistan, for which he wrote a report on Elimination of Ribā. Khan has also served as a Vice-President of the International Islamic University, Islamabad and continues to be an Honorary Adviser to the President of that University.

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