



Woodrow Wilson  
International  
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for Scholars

*Asia Program*

# Islamization and the Pakistani Economy



Edited by  
Robert M. Hathaway and Wilson Lee

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**Ishrat Husain  
Khurshid Ahmad  
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Parvez Hasan  
Omar Noman  
Isobel Coleman  
Vali Nasr  
Charles H. Kennedy  
Saeed Shafqat**

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## INTRODUCTION

ROBERT M. HATHAWAY

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In the aftermath of the September 11, 2001, attacks on the World Trade Center and the Pentagon and the wars in Afghanistan and Iraq, it is more important than ever that Americans develop a more nuanced understanding of Islam and the Islamic world. Notwithstanding its enormous power, the United States can no longer afford to remain uninformed about the people, culture, and values of the countries where Islam exerts a predominant influence. Thinking in stereotypes or blindly lumping all Muslims into one-size-fits-all mental categories will not help win the war on terrorism. More broadly, fostering an undifferentiated image of Islam and the nations where Islam prevails is counterproductive to the achievement of a range of important U.S. interests, and violates American values of inclusiveness and fair-mindedness.

Pakistan is the second most populous Muslim-majority country in the world, and within a few decades will be the world's fifth largest country. It is located at the strategic crossroads of Asia and the Middle East, and is adjacent to the Middle East's vast oil fields and to some of the globe's most sensitive sea lanes. It is an acknowledged nuclear weapons state. It is a key player in the global war against terrorism, and itself a victim of terrorism. It has also been accused of fomenting terrorist activities, and providing refuge to remnants of al Qaeda and the Taliban. Although it has been an American ally and partner, off and on, for fifty years, many Pakistanis believe, erroneously, that the United States is hostile to Pakistan, and to the Islamic beliefs professed by most Pakistanis. For their part, most Americans know little about Pakistan and remain supremely unaware of the many ways in which U.S. and Pakistani interests coincide, intersect, and sometimes clash.

As part of its effort, accentuated since September 11, 2001, to help foster a sounder American understanding of the Islamic world, the Woodrow

Wilson International Center for Scholars hosted a daylong conference in January 2004 exploring the likelihood and consequences of a course of action being pushed by important political and religious groups in Pakistan: the adoption by Pakistan of an Islamic economy. Conference organizers made no assumption whether Pakistan would move farther in this direction; they simply wished to examine more closely one of the options now being discussed in Pakistan, and especially to identify some of the implications for Pakistan's financial and economic well-being should the country decide to pursue this course.

Many scholars assert that the desire to establish an Islamic economy in Pakistan is nearly as old as Pakistan itself. The Objectives Resolution, adopted by Pakistan's first Constituent Assembly, stipulated that the country's Muslims should order their lives in accordance with the teachings and requirements of Islam, as conveyed in the Holy Quran and Sunnah. This seminal statement of intent was subsequently incorporated into each of Pakistan's three constitutions, and stands today as one of the key documents in the country's political and constitutional history.

In the decades since Pakistan's founding in 1947, a variety of institutions have been created to assist in the task of Islamization. The Council of Islamic Ideology, the constitutionally mandated Islamic Research Institute, the federal *Shariat* Court, and similar bodies were all enjoined to promote the reconstruction of Pakistan on "a truly Islamic basis" (to quote from the 1956 constitution). These efforts received a further boost after General Muhammad Zia ul-Haq assumed power in the late 1970s.

Yet by most measures, these endeavors have fallen well short of Islamizing Pakistan's economy. For instance, in the financial sector, Pakistan (like Malaysia) has adopted a system of Islamic banking that operates in parallel with the conventional banking system. Pakistanis can choose between the two modes of financing. Most informed Pakistanis, however, insist that there is no concerted move to do away altogether with the conventional banking system, or to replace existing linkages and relationships with international financial markets.

Pakistan's October 2002 national elections reinvigorated the drive to establish an Islamic economy in that country. The polling produced an unexpectedly strong showing by a coalition of six Islamic parties (the Muttahida Majlis-e-Amal, or MMA), which won sixty seats in the National Assembly (compared to two in the previous election), captured



control of Pakistan's Northwest Frontier Province, and secured a prominent role in the coalition government of Baluchistan.

Several of the MMA parties have called for Pakistan to adopt an economic system in conformity with their interpretation of Islam. Political leaders and government officials not associated with the MMA coalition have also picked up this cry for Islamizing Pakistan's economy. Indeed, in his budget speech for 2002-03, the country's finance minister declared: "Let me reiterate the intention of the government to promote Islamic banking in the country." He then muddied the waters somewhat by adding, "...while keeping in view its linkages with the global economy and existing commitments to local and foreign investors."

Pakistan's economy has achieved some notable successes over the past several years. Many economists and members of the business community worry that an attempt to impose an Islamic economy on Pakistan could undercut this progress and have devastating economic, political, and social consequences for the country. Yet, the MMA represents one of the few large, widely supported political forces in Pakistan. Moreover, it would appear that even many secular-minded Pakistanis, frustrated by the perceived failures of both the current government and its predecessors, are inclined to give the MMA a chance to govern. If the National Assembly in Islamabad and Pakistan's provincial governments succumb to political gridlock, the MMA is likely to gain additional support by portraying itself as a vigorous and principled political force.

As the essays in this volume make clear, there exists little consensus on what "an Islamic economy" would actually look like. One leading Islamic scholar, Khurshid Ahmad, whose work appears in these pages, argues that the phrase signifies an *approach* as much as any well-defined set of financial, theological, or legal norms and practices. Ahmad also insists that private property and enterprise, self-interest, market mechanisms, and competition are as integral to Islamic economics as to free-market capitalism. Islamic economics do not challenge the right of capital to enjoy a just return. An Islamic economic system need be neither autarkic nor isolationist, and Islamists do not call for a withdrawal from the international economic order.

Almost any definition of Islamic economics, however, includes a prohibition on *riba* (usually translated "interest" or "usury") and an emphasis on *zakat*. The latter constitutes the voluntary (at least in theory) obliga-

tion on all good Muslims to share a certain percentage of their wealth with the less fortunate. *Zakat* is designed to serve as something of a social safety net for the underprivileged. Conventional banking systems can exist side-by-side with Islamic banking, and frequently do. Indeed, large western banks, including Citigroup and HSBC, offer Islamic financial products. According to Omar Noman, a senior official with the UN Development Program, an estimated 200 institutions in 60 countries offer an interest-free alternative to conventional banking. In reality, however, the return these institutions provide through a variety of imaginative equity-based non-interest instruments tends to mirror the prevailing interest rate in the economy.

Fears about the Islamization of the country's economy, asserted the governor of the State Bank of Pakistan, **Ishrat Husain**, in the January 27 conference's keynote address, are absurd, and serve merely to underscore the clichés and stereotypes of Pakistan and Islam widely held in the West. "Most of the assumptions and premises on which the hypotheses about the Islamic economic system have been constructed are seriously flawed," Governor Husain contends in the opening essay in this report. "Pakistan is and will remain a responsible member of the international community." After briefly surveying Pakistan's economic record since 1947, with an emphasis on the years since 1999, when General Pervez Musharraf seized power in a military coup, Husain concludes that Pakistan is far removed from the day when it will be ready to adopt a full-fledged Islamic economic system.

Even so, Husain continues, non-Muslims should not fear such a system, since Islamic economics represent nothing more than an attempt to promote "a balance between market, family, society and the state." The Islamic economic model seeks to harmonize self-interest with the social interest. It gives self-interest a "longer-term perspective" by encouraging the individual to fulfill his or her social obligations. Islamization, if fully practiced, will address those income distribution and poverty alleviation issues where capitalism has fallen short. This in turn would serve to "eliminate the sources of instability, violence and propensity towards terrorism arising from a sense of deprivation." The world, in short, would be a far happier place were the Muslim world to adopt an Islamic economic model.

Professor **Khurshid Ahmad**, a member of the Pakistani Senate, an influential Islamic intellectual, and one of the senior leaders in the MMA,

also emphasizes the idea that Islam is not merely a religion in the limited sense of the term, but can serve as a guide for human interaction in all realms. The modern world, he argues, has severed the links between economics and ethics. Efficiency has been given precedence over justice and equity. A new holistic approach—an Islamic approach—is needed, so that productive efficiency and distributive justice can coexist. Those who support an Islamic economy, he writes, “seek to reintegrate economics with ethics. Efficiency and equity become elements of a composite reality.” Ahmad concludes his contribution to this volume by recalling British economist John Gray’s admonition that free-market capitalism is a manifestation of a specific cultural milieu. Rather than imposing a possibly alien economic system on Pakistan, Ahmad asserts, the global economy must be reformed so as to accept “a diversity of cultural regimes and market economies as a permanent reality.”

Former World Bank officer **Shahid Javed Burki**, who also served as Pakistan’s finance minister for a brief time in the 1990s, explores three issues in his essay: why the effort to bring Islamic principles to economic management in Pakistan has proceeded so unevenly over the years; how far Pakistan has gone in Islamizing its economic and financial sectors; and how much farther it is likely to move. Burki concludes that pragmatism has usually prevailed over piety, that efforts to Islamize the banking system have been largely cosmetic, and that rather than replace conventional institutions, Pakistan is likely to move, albeit slowly, towards a system of parallel banking and financial institutions that provide greater choice to the Muslim consumer. He also judges that notwithstanding the recent electoral successes of the MMA, most Pakistani savers and investors have no overwhelming desire to move towards an Islamized economy. “The Islamic economic system in Pakistan is still underdeveloped and will remain that way for a long time to come.”

Longtime Pakistani civil servant and World Bank official **Parvez Hasan** looks at issues of poverty and social justice in Pakistan in his essay, and returns to a theme introduced by earlier contributors—the idea that ethics cannot be separated from economics. Pakistan has done a very poor job of poverty alleviation, Hasan maintains. Today 45 million Pakistanis—a figure larger than West Pakistan’s entire population at the time of its birth 57 years ago—live in poverty. Moreover, inequalities are growing. The discussion of an Islamized economy has not adequately

addressed these glaring failures, Hasan suggests. The private charitable transfers envisioned under the system of *zakat*, for instance, only minimally help the poorest sectors of society. Until Islamic scholars address more realistically the matters of human development, poverty alleviation, inequality, and the creation of a fair society, Islamization per se is likely to offer little solace to the large number of Pakistanis whose lives are mired in poverty and destitution.

The essay by **Omar Noman**, a senior official in the UN Development Program and an adviser to several Pakistani governments, also emphasizes the generally poor showing of Muslim countries in measurements of human development, such as female literacy, life expectancy, and access to safe drinking water. Noman then suggests that an interest-free economy reflects pious yearnings rather than demonstrated socio-economic performance, and would do nothing to help raise Pakistan's deplorably low human development levels. After reviewing the debate among Islamic scholars whether the Quran bans all forms of interest, or only usury, Noman finds that the push for an "interest-free economy" represents the agenda of one faction in this dispute and not, as is sometimes assumed, the consensus view of Islamic theologians. Adopting a "theologically based economy," Noman argues, "makes no political or economic sense" for Pakistan. Such a move, moreover, would run counter to Musharraf's efforts to portray Pakistan as a modern, liberal Muslim state.

Continuing the focus on Pakistan's undistinguished human development record introduced in the two previous essays, the Council on Foreign Relations' **Isobel Coleman** examines the impact of Islamization on women. This is not merely an ideological question of inequality, she argues; gender discrimination retards development and exacts a large toll on both present and future generations. Coleman explores Pakistani gender disparities in literacy and workforce participation to support her assertion that such inequalities impose severe constraints on sound economic growth. Many Islamists insist that their policies are egalitarian and even women-friendly, she notes. Moreover, Pakistan's constitution guarantees equal rights to women. But if Islamization per se does not mandate gender discrimination, she writes, "Islamization tends to reinforce conservative ideas regarding the role that women should play in society. At a minimum, this slows down policies and programs designed to bring women more into the public sphere, and thereby exacts an economic cost."

Academic studies, Coleman continues, suggest that “closing significant gender gaps can add as much as 1 percent annually to per capita GNP growth.” The question for Pakistanis, she concludes, is whether they can afford Islamization’s conservative notions about women.

The “central issue” in Pakistani politics over the years, argues **Vali Nasr** of the Naval Postgraduate School, Monterey, has been the expansion of state power and the resistance these efforts have provoked. Islamization and its economic dimension, Nasr maintains, must be examined within this broader context. In Pakistan, successive governments have manipulated Islamic symbols not only to shore up state legitimacy, but to cast their redistributive policies in a favorable political light. This, in turn, has encouraged the political opposition to mobilize along religious lines as well. Political conflicts have frequently been fought over either land reform or the government’s compulsory collection of religious taxes, but the underlying issues usually involved the intrusion of the state into domains claimed by the religious establishment. This establishment, finding its social and economic position under assault, responded by questioning the Islamic credentials of the offending government. In short, the debate over Islamization in Pakistan has historically been “a manifestation of deep-seated struggles between the weak and developing Pakistan state and powerful social forces,” including an influential religious leadership.

**Charles Kennedy**’s contribution to this volume reviews the “convoluted history” of Islamic legal efforts to secure a judicial ruling that *riba*, or financial interest, is repugnant to Islam, and therefore, that all federal and provincial laws that provide for *riba* must be brought into conformity with Islamic law. His analysis underscores the essentially political rather than legal character of this question. Even Zia ul-Haq, who professed to want to govern Pakistan according to Islamic precepts, and who in 1979 publicly pledged to eliminate *riba* from Pakistan within three years, nonetheless opted for “prudential, incremental” changes that “did not seriously challenge the operations or the corporate interests of domestic banks or Pakistan-based affiliates of multinational banks.” As of today, Kennedy concludes, legal efforts to secure the prohibition of *riba* have been effectively derailed. Those who wish to pursue this goal further “are left with little recourse save trying to convince a heretofore dubious and disinterested public.”

Columbia University scholar **Saeed Shafqat** writes of the decades-old partnership between the Pakistani army and the “religious right,” the

predicament of “liberal/modernist leadership” in Pakistan, and the need to “reinvent” Pakistan. The West need not fear Pakistan’s religious parties, which have demonstrated a pragmatism and, as they move into positions of power, will no doubt develop a greater stake in the system. Unfortunately, parties have traditionally been more interested in power than in reform; this has to change if Pakistan is to be truly rejuvenated. Shafqat analyzes the shift in Pakistani politics over the past three decades, away from mass mobilization and agitation toward a “politics of coalition-building and interest aggregation.” This transformation in the nature and purpose of Pakistani politics is closely linked to changes in the composition of Pakistan’s military and bureaucratic elites. The future of democracy and the consolidation of democratic institutions in Pakistan, Shafqat warns, hinge on the disengagement of the military from civil sectors; revival, sustenance and restoration of the legitimacy of mainstream political parties; and professionalization of the civil service.

In brief concluding remarks during the Wilson Center conference in January, **Akbar Ahmed** of American University argued that South Asia’s Muslims have much to contribute to the global debate concerning the nature of Islam. Mohammed Ali Jinnah, Pakistan’s founder, stood for democracy, human rights, minority rights, and respect for constitutionalism and the law. Islam, Ahmed asserted, is about far more than the 19 hijackers of September 11th; it is also about compassion and tolerance. Islam has answers to many of the fears about itself prevalent in the West today, even if Muslims in recent times have failed to address those anxieties adequately. What is most needed, Ahmed concluded, referring back to Shafqat’s formulation, is not Pakistan’s “reinvention,” but its “rediscovery.” That is, Pakistanis must go back to their roots, to the country’s *raison d’etre*. In so doing, Pakistan can escape the suspicions under which it presently labors and take its rightful place among the nations of the world.

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Neither the Wilson Center conference in January 2004 nor this publication would have been possible without the help of many individuals. My thanks to Ambassadors Dennis Kux and William Milam, friends and esteemed colleagues here at the Wilson Center, who generously shared their considerable knowledge of Pakistan with me during the formative

stages of this endeavor, and who chaired panels during the conference. Dr. Ishrat Husain, governor of the State Bank of Pakistan, graciously carved time out of a demanding schedule in order to come to Washington specifically to deliver the conference's keynote address. Invaluable assistance of another sort has been provided by the Fellowship Fund for Pakistan (FFFP), a charitable trust based in Karachi, whose financial munificence has enabled the Wilson Center to expand its Pakistan programming dramatically. FFFP chairman Munawar Z. Noorani has been the driving, indeed the indispensable, force behind the creation of the Fund. More than any other individual, he has provided the vision and the energy that have made possible the Center's enhanced Pakistan activities, and I wish to acknowledge publicly my considerable debt and my deep appreciation for his efforts and for the confidence in the Wilson Center and its Asia Program he has demonstrated. Lastly, the creative talents of Wilson Lee, my associate and colleague here in the Center's Asia Program, have transformed the initial drafts of these essays into the volume you hold in your hands. Deep and abiding thanks to Wilson for his splendid work, his unfailing enthusiasm, and his commitment to fostering a deeper understanding of Pakistan and the world of Islam.

## The Economy of Pakistan: Past, Present and Future

ISHRAT HUSAIN

*Ishrat Husain is currently governor of the State Bank of Pakistan. Prior to his appointment in December 1999, Dr. Husain was director for the Central Asian Republics at the World Bank. Previous positions at the World Bank include director of the Poverty and Social Policy Department, chairperson of the Public Sector Group, and chief economist for Africa and for the East Asia and Pacific region. Prior to joining the World Bank, he served in the civil service of Pakistan. His publications include Economic Management in Pakistan, 1999–2002 and Pakistan: The Economy of an Elitist State. He holds a doctorate in economics from Boston University.*

In this shrinking global village, internet chats, cable TV, talk shows and transmissions through satellite dishes have made perceptions more powerful than realities in influencing public opinion. There is a widely held perception in Pakistan—right or wrong—that the popular American view of the U.S.S.R. as an evil empire and communism as a threat to economic and social stability of the world is beginning to resonate itself, with Islam replacing communism and Pakistan and other Muslim countries standing in for the U.S.S.R.

Those who hold this perception point, as an example, to the recent Council of Foreign Relations/Asia Society Task Force Report, which aptly sums up the popular American view about Pakistan in the following sentences: “Pakistan presents one of the most complex and difficult challenges facing U.S. diplomacy. Its political instability, entrenched Islamist extremism, economic and social weaknesses and dangerous hostility towards India have cast dark shadows over this nuclear-armed nation.”

It is in this context that the Woodrow Wilson Center deserves our commendation for organizing this conference to explore in depth one of the



elements of this newly emerging conventional wisdom about Islam and Pakistan—although each one of the components of the above statement deserves further analysis and discourse to sift out the facts from myths.

I hope that the candid discussion today will enlighten many of us, clarify a number of issues, and debunk some of the popular myths surrounding Islam and Pakistan's economic direction.

I have chosen to focus my remarks today on the one aspect of Pakistan and Islam that is, in my view, hardly discussed and least known but creates a lot of jitters in the United States. This has increased importance since the elections of October 2002, when an alliance of religious parties won power in the Northwest Frontier Province. I propose to walk you through the past and current trends of the Pakistani economy, sketch the future direction, and offer my own assessment of how the adoption of an Islamic economy, if it indeed happens, will affect Pakistan's future.

This paper is divided into six sections.

The first section deals with the past achievements and failures of Pakistan's economy. The second section presents a synopsis of economic performance during 1999-2003—a period of intensive restructuring and reforms of the economy. Section III distills the policy lessons learned from the historical and most recent experience of Pakistan's economic management. Section IV attempts to lay down the contours of the future direction of Pakistan's economy based on the lessons learned and development experience gained from in-country and cross-country record. Section V assesses how the attempts to introduce an Islamic economic model in the country, if successful, will impact upon this future direction. The final section provides insights into the economic prospects of Pakistan in the medium term.

## **I: PAST ACHIEVEMENTS AND FAILURES**

Pakistan was one of the few developing countries that had achieved an average growth rate of over 5 percent over a four-decade period ending 1988-89. Consequently, the incidence of poverty had declined from 40 percent to 18 percent by the end of the 1980s. Table I lays down the main economic and social indicators in 1947 and compares them with 1997 and 2001. The overall picture that emerges from a dispassionate examination of these indicators is that of a country having made significant economic

*Table I: Long-Term Structural Change and Growth*

		1947	1970	2001
<b>Population</b>	<b>In millions</b>	<b>33</b>	<b>60</b>	<b>146</b>
<b>Income</b>	GDP (current m.p.) Rs.blm	58	151	3,231
	GDP (U.S. \$)billion	3.8	10.8	72.3
	Per Capita Income (constant Rs.)	1,638	2,541	5,383
	Per Capita Income (U.S. \$)	85	70	495
	Per Capita Income (current Rs.)	405	809	28,980
<b>Agriculture</b>	Production Index	100	219	530
	Fiber Production Index	100	172	921
	Water Availability (MAF)	55	76	97
	Wheat Production (m. tons)	3.3	7.3	19.2
	Rice Production (m. tons)	0.7	2.4	4.8
	Cotton Production (m. bales)	1.1	3.0	10.4
	Fertilizer per ha. Crop (kg)	0	23	212
<b>Industry</b>	Manufacturing Production Index	100	2346	12,633
	Steel Production (000 tons)	0	0	2203

		1947	1970	2001
<b>Population</b>	<b>In millions</b>	<b>33</b>	<b>60</b>	<b>146</b>
<b>Industry (cont'd.)</b>	Cement Production (000 tons)	292	2656	11,000
	Chemical Production (000 tons)	0	130	445
	Sugar Production (000 tons)	10	610	3686
	Veg. Ghee Production (000 tons)	2	126	743
	Cloth Production (000 sq. meter)	29,581	60,544	576,000
<b>Infrastructure</b>	Per Capita Electricity Generation (Index)	1000	1950	10,160
	Per Capita Electricity (kwh)	6	63	520
	Road Length (km)	50,367	72,153	249,959
	Area under Canal Irrigation (mill. ha)	7.9		18.0
<b>Consumption</b>	Natural Gas billion cu. Meters	0	2.9	26.1
	Road Vehicles per 1000 Persons	1	3	30
	Phone Connections per 1,000 Persons	0.4	2.5	28.6
	TV Sets per 1,000 Persons	0	1.5	26.3
<b>Social indicators</b>	Primary Enrollment Rate	5	22	74
	Population per Doctor	23,897	4,231	1,484

		1947	1970	2001
<b>Population</b>	<b>In millions</b>	<b>33</b>	<b>60</b>	<b>146</b>
<b>Social indicators (cont'd.)</b>	Population per Nurse	369,31	13,141	3,560
		8		
	Literacy Rate	11	20	51
	Infant Mortality Rate	N.A.	117	84
	Total Fertility Rate	N.A.	6.3	4.7
	Population with Access to Safe Water	N.A.	25	85
	Under Five Mortality Rate	N.A.	181	109

achievements but with a disappointing record of social development. The salient features of Pakistan's economic history are:

- A country with 30 million people in 1947 could not feed itself and had to import all its food requirements from abroad. In 2002, the farmers of Pakistan were not only able to fulfill the domestic needs of wheat, rice, sugar, and milk of 145 million people at a much higher per capita consumption level, but also exported wheat and rice to the rest of the world.
- An average Pakistani earns about \$500 in 2003, compared to less than \$100 in 1947. In current U.S. dollar terms, the per capita income has expanded more than five-fold and in constant terms three times.
- Agriculture production has risen five times, with cotton attaining a level of more than 10 million bales compared to 1 million bales in 1947. Pakistan has emerged as one of the world's leading exporters of textiles.
- Pakistan hardly had any manufacturing industries in 1947. Five decades later, the manufacturing production index is 12,000, with a base of 100 in 1947. Steel, cement, automobiles, sugar, fertilizer, cloth and vegetable

ghee, industrial chemicals, refined petroleum and a variety of other industries manufacture products not only for the domestic market but in many cases for the world market too.

- Per capita electricity generation in 2003 was 10,160 kwh compared to 100 in 1947. Pakistan's vast irrigation network of large storage reservoirs and dams, barrages, and link canals constructed during the last five decades has enabled the country to double the area under cultivation to 22 million hectares. Tubewell irrigation provides almost one-third of additional water to supplement canal irrigation.
- The road and highway network in Pakistan spans 250,000 kilometers—more than five times the length inherited in 1947. Modern motorways and super highways and four lane national highways link the entire country along with secondary and tertiary roads.
- Natural gas was discovered in the country in the 1950s and has been augmented over time. As of now, almost 26 billion cubic meters of natural gas is generated, transmitted and distributed for industrial, commercial and domestic consumption.
- Private consumption standards have kept pace with the rise in income. There are 30 road vehicles for 1,000 persons in 2001, relative to only one vehicle for the same number of people in 1947. Phone connections per 1,000 persons have risen to 28.6 from 0.4. television sets, which were non-existent, adorn 26.3 out of every 1,000 houses.

These achievements in income, consumption, agriculture and industrial production are extremely impressive and have lifted millions of people out of poverty. But these do pale into insignificance when looked against the missed opportunities. The largest setback to the country has been the neglect of human development. Had the adult literacy rate been close to 100 instead of close to 50 today, it is my estimate that per capita income would have reached at least \$1,000 instead of \$500.

Pakistan's manufactured exports in the 1960s were higher than those of Malaysia, Thailand, Philippines or Indonesia. Had investment in educating and upgrading the training, skills and health of the labor force been up to

the level of East Asian countries, and had a policy of openness to world markets been maintained without any breaks, Pakistan's exports would have been at least \$100 billion instead of a paltry \$12 billion. Had the population growth rate been reduced from 3 percent to 2 percent, the problems of congestion and shortages in the level of infrastructure and social services would have been avoided, the poor would have obtained access to education and health, and the incidence of poverty would have been much lower than what it is today.

But as if this neglect of human development was not enough, the country slacked in the 1990s and began to slip in growth, exports, revenues, and development spending, and was entrapped in a deep morass of external and domestic indebtedness. As a result, the incidence of poverty rose from 18 percent in 1988-89 to 33 percent by the end of the 1990s. This was due both to fundamental structural and institutional problems as well as to poor governance and frequent change in political regimes. With short life spans, succeeding governments were hesitant, if not outright unwilling, to reform the rent-seeking activities of the ruling elite—consisting of a small class of politicians, bureaucrats businessmen, feudal landlords and other vested interests—and desisted from taking tough unpopular economic decisions to set the economy right. Understandably, they were more preoccupied with the imperatives of retaining political power, and making such decisions could have further exposed them to the risk of removal from office. Moreover, the average government lifespan of two to three years was clearly inadequate for meaningful policy or institutional change. The external environment was also unfavorable as the inability of successive governments to meet their commitments with international financial institutions led to a serious credibility gap among the donors and intermittent withdrawal of assistance. The events of May 1998, when Pakistan conducted their first nuclear test, and their aftermath led to further economic isolation of Pakistan and a considerable erosion of confidence by domestic and non-resident Pakistanis. Economic sanctions were imposed against Pakistan by the Western governments. By the late 1990s, Pakistan had entered an almost critical state of paralysis and stagnation in its economy, particularly in its external sector. The freezing of foreign currency accounts had resulted in a significant drop in workers' remittances; export growth was negative; IMF programs and World Bank assistance were suspended; and bilateral donors had terminated their aid, while debt payments due were far in

*Table II: Changes in Key Macroeconomic Indicators*

	<b>October 1999</b>	<b>September 2003</b>	<b>Change in the Indicator</b>
<b>GDP growth rate</b>	4.2%	5.3%	Positive
<b>Inflation</b>	5.7%	3.3%	Positive
<b>Fiscal deficit/GDP</b>	-6.1%	-4.0%	Positive
<b>Current account/GDP</b>	-3.2%	+5.0%	Positive
<b>Domestic Debt/GDP</b>	52.0%	43.4%	Positive
<b>External Debt</b>	\$ 38 billion	\$ 35 billion	Positive
<b>Remittances</b>	\$ 88 million per month	\$ 300 million per month	Positive
<b>Export \$</b>	7.8 billion	\$ 12 billion	Positive
<b>Tax Revenues</b>	Rs. 391 billion	Rs. 510 billion	Positive
<b>Rupee-Dollar Parity</b>	Depreciating	Appreciating	Positive
<b>Foreign Direct Investment</b>	\$ 472 million	\$ 500 million	Positive
<b>Foreign Exchange Reserves</b>	\$ 1.6 billion	\$ 12.0 billion	Positive
<b>Poverty Incidence</b>	33%	Data not available but perhaps rising	Negative
<b>Poverty related expenditure</b>	Rs. 133 billion	Rs. 161 billion	Positive
<b>Unemployment</b>	6%	8%	Negative

Note: All indicators in Column 1 pertain to 1998-99 or October 1999. All indicators in Column 2 pertain to 2003-04 or end September 2003.

excess of the liquid foreign exchange resources the country possessed. Pakistan was almost at the brink of default on its external payments.

## **II: ECONOMIC PERFORMANCE, 1999-2003**

It was at this stage that the military government under General Pervez Musharraf assumed power in October 1999. The economic team of the new government devoted the initial period to managing the crisis and making sure that the country avoided default. A comprehensive program of reform was designed and implemented with vigor and pursued in earnest, so as to put the economy on the path of recovery and revival. The military government did not face the same constraints and compulsions as the politically elected governments. It was therefore better suited to take unpopular decisions—imposing a general sales tax, raising prices of petroleum and utilities, and removing subsidies—so badly needed to bring about fiscal discipline and reduce the debt burden. The IMF and the World Bank were invited to enter into negotiations on new stand-by and structural adjustment programs.

Although the canvas of reform in Pakistan was vast and corrective action was required on a number of fronts, there was a conscious effort to focus on achieving macroeconomic stability, on certain key priority structural reforms and improving economic governance. The structural reforms included privatization, financial sector restructuring, trade liberalization, picking up the pace of deregulation of the economy and generally moving towards a market-led economic regime. A stand-by IMF program was put in place in November 2000, and was successfully implemented, followed by a three-year Poverty Reduction and Growth Facility (PRGF), which will expire in November 2004. What have been the outcomes of the economic reforms undertaken during the past four years?

### ***Macroeconomic Stability***

There has been considerable progress in achieving macroeconomic stability. Strong fiscal adjustment has led to primary budgetary surplus and significant reduction of the fiscal deficits. The current account has turned around from a chronic deficit to a surplus of more than 5 percent of GDP, mainly due to renewed export growth and resurgence of workers' remittances. Monetary aggregates have been contained, and the inflation rate is



below 4 percent. The external debt burden has been reduced in absolute terms from \$38 to \$35 billion, and as a proportion of GDP from 62.5 percent to 46 percent. The risk of default on external debt, which loomed large on the horizon in 1999 and 2000, was mitigated and the country's capacity to service its restructured debt has considerably improved. The exchange rate has not only stabilized but appreciated during the last two years. Table II shows the changes in the key economic indicators between October 1999 and September 2003.

### ***Structural Reforms: Privatization, Deregulation, Liberalization***

The Musharraf government actively pursued an aggressive and transparent privatization plan, whose thrust was the sale of assets in the oil and gas industry as well as in the banking, telecommunications and energy sectors, to strategic investors, with foreign investors encouraged to participate in the privatization process. This plan is being followed by the newly elected government under Prime Minister Jamali.

To demonstrate the seriousness of the government in encouraging foreign investment flows into Pakistan, there has been a major, and perceptible liberalization of the foreign exchange regime. Foreign investors can now bring in and take back their capital and remit profits, dividends and fees, without any restrictions. Foreign portfolio investors (FPI) can also enter and exit the market without any restrictions or prior approvals. In the Karachi Stock Exchange, with a market capitalization of \$15 billion, over 700 listed companies showed average returns of 15 percent, which were higher than those in most emerging countries. This makes Pakistan an attractive place to invest for foreign portfolio investors. As part of this liberalization, non-residents and residents are allowed to maintain and operate foreign currency deposit accounts, and a market-based exchange rate in the interbank market is at work.

Allied to this effort, the trade regime has been opened up and the maximum tariff rate has been cut down to 25 percent with only four slabs, and the average tariff rate is down to 14 percent.

The financial sector too, has been restructured and opened up to competition. Foreign and domestic private banks currently operating in Pakistan have been able to increase their market share to more than 60 percent of assets and deposits. The interest rate structure has been deregulated, and monetary policy uses indirect tools such as open market operations, and dis-

count rates. Domestic interest rates on lending have dropped to as low as 5 percent from 20 percent, substantially reducing financial costs of businesses.

Central to the economic reforms process has been a clear progression towards deregulation of the economy. Prices of petroleum products, gas, energy, agricultural commodities and other key inputs are determined by the market, and imports and domestic marketing of petroleum products have been deregulated and opened up to the private sector. The markets do not always function effectively. Independent regulatory agencies have been set up to protect the interests of consumers and end-users of utilities and public services. Despite this movement towards a liberalized and deregulated regime, old habits die hard. Bureaucratic hassles at lower levels continue to be irritants for the business community.

### ***Tax Reforms***

Taxation reform has figured prominently on the government's agenda, as this is another area where the business community has innumerable grievances and dissatisfaction with the arbitrary nature of tax administration. Tax reforms are aimed at broadening the tax base, bringing in tax evaders under the tax net, minimizing personal interaction between tax payer and tax collector, eliminating the multiplicity of taxes and ultimately reducing the tax rate over time. A massive survey and documentation drive was undertaken to widen the tax base, extend incidence to all sectors of the economy and develop data for purposes of assessment. Despite these reforms, the business community remains dissatisfied with the performance and attitude of tax officials, particularly at the lower level. Complaints of delays in refunds of sales tax persisted throughout the three-year period. The Central Board of Revenue (CBR) is being restructured to improve tax administration, including taxpayer facilitation.

### ***Economic Governance***

The most dramatic shift introduced by the military government is in promoting good economic governance. Transparency, consistency, predictability and rule-based decision-making have begun to take root. Discretionary powers have been significantly curtailed. Freedom of the press and access to information has had a salutary effect on the behavior of decision makers. The other pillars of good governance are (a) the devolution of power to the local governments, which will have the

administrative and financial authority to deliver public services to all citizens, and (b) an accountability process that will take to task those indulging in corruption through a rigorous process of detection, investigation and prosecution.

Despite these positive outcomes and their impact on the business community and other stakeholders, within the country as well as abroad, the incidence of poverty is still quite high and unemployment rates are worrisome. The challenge, therefore, for the next phase of the reform process is to accelerate the growth rate and reduce poverty and unemployment.

### **III: POLICY LESSONS LEARNED**

I now turn to the policy lessons learned from the experience of the last 50 years and the success achieved in reforming and restructuring Pakistan's economy during the last four years. With experiments running from state controls, liberalization, socialism, reversal to market mechanisms, deregulation and privatization, there is today almost a consensus on the broad contours of economic policy in the country, although the modalities, policy instruments and nuances differ, as they ought to. My reading of the last 15 years suggests that the general thrust of Pakistan's economic policies broadly reflects the following lessons learned from the past:

- Central planning has been a failure, as it leads to low productivity, lack of innovation, lack of incentives, poor quality goods and services and low investment in human resources. Bureaucratic judgment is a poor substitute for the market's judgment on allocation of scarce resources.
- Licensing to open, operate, expand, and close businesses by government functionaries is a sure way to promote rent-seeking in the economy for the benefit of a few while keeping the majority poor. Basic business decisions should not be made for the businessmen by bureaucrats.
- Public sector ownership and management of business, production, distribution and trade do not capture the commanding heights but lead to a fall into the deep morass of inefficiency, waste and corruption.

- Import substitution behind high tariffs not only protects a few thousand inefficient producers but also penalizes millions of consumers with shoddy and expensive goods, which they do not particularly want. Profits at world prices are negative in these protected industries, thus leading to inefficient utilization of capital and labor.
- Over-regulation, controls and inspection of all kinds on the private sector not only hike up the cost of doing business and subdue entrepreneurship, but also make a few wily politicians and bureaucrats rich at the expense of the prosperity of the country. Private monopolies and oligopolies were nurtured under the cover of these controls.
- High tax rates on individuals and corporations are counter-productive as they raise costs, discourage effort and initiatives and lead to widespread tax evasion and have unintended consequences of lowering overall revenue collection.
- Banks and financial institutions owned and managed in the public sector and offering cheaper credit and/or directed credit have a pernicious effect on economic growth, as credit decisions are made on the basis of political connections rather than the merit of the proposal. Value subtracting enterprises are set up while real opportunities for businesses that contribute to output and employment are missed.
- Administered prices of key commodities and utilities are the worst possible means of insulating the poor segment of the population from the onslaught of market forces. Instead, these prices create shortages in the economy and hit the poor hardest by denying them access to essential commodities or services.
- Subsidies on inputs such as fertilizers, seeds, electricity, water, gas and petroleum incur heavy budgetary costs but benefit the well-to-do classes and highly influential individuals rather than those for whom the subsidies are intended.
- Foreign investment and multinational corporations are not evils that should be shunned but are the most important conduits for transfer of

technology, managerial skills, organizational innovation in addition to much needed capital and foreign exchange. They should be welcomed and made to feel comfortable in their operations.

#### **IV: FUTURE DIRECTIONS**

The lessons learned from historical experience, development literature based on cross-country records and the imperatives of globalization have led to the emergence of a broad consensus on some key policies and parameters.

These views are shared by a majority of the political parties, military, businesses, bureaucracy and other stakeholders in Pakistan. It will be fair to surmise that investors in Pakistan should feel confident that the future direction of economic policy making will be guided by the following principles, although in a dynamic and ever changing world, economic management will have to be responsive to the needs of the time and events.

- An outward-looking strategy that promotes exports and integrates Pakistan into the world economy is in the best interest of the country for accelerating growth and reducing poverty. Tariff reductions have been quite drastic from 220 percent to the current maximum of 25 percent, helping the businesses to become cost competitive. Anti-export bias has been significantly reduced and export promotion is the stated policy objective.
- The private sector is the main vehicle for producing and exchanging goods and services for the domestic economy as well as the rest of the world. Prices should be determined by market forces, but monopolies should be regulated by independent agencies.
- The role of the state is to provide security of life and property, have an independent judiciary that can arbitrate disputes and enforce contracts, build physical infrastructure, nurture human skills and train manpower and maintain an enabling macroeconomic and regulatory environment in which businesses can flourish.

- Public sector enterprises and government trading houses should be privatized through a transparent process so that the government can focus its attention on its basic responsibilities to the citizens. Selling these enterprises to private entrepreneurs has stopped the hemorrhaging of government finances.
- Pakistan will continue to have a liberal foreign exchange and low-tariff regime without recourse to non-tariff barriers. Raw materials, components, machinery and equipment, and consumer goods can enter the country free of restrictions. Foreign investors are free to bring in and repatriate capital, dividends, profits, remittances, royalties, etc. without any approvals.
- The value of the Pakistani currency in relation to other foreign currencies will be determined through supply and demand in the foreign exchange markets and not by administrative fiat of the Central Bank. A free-floating exchange rate policy is being pursued at present and will continue in the future.
- The Central Bank or the government no longer controls interest rates on government securities, corporate borrowing, deposits, etc. They are totally deregulated and the banks are free to charge spreads according to the risk assessment of the borrowers. There are no priority sectors to which credit is directed. Government is not allowed to borrow from the banking system beyond a specified limit.
- Foreign companies, individuals, and multinational corporations can own 100 percent shares in locally incorporated or unincorporated firms. They can raise equity through national stock markets, borrow from the local banking system and sell their goods or services abroad or domestically. They enjoy a level playing field with the domestic investors and do not face any barriers to entry or exit. They can expand capital or wind up business without permission from any government department.
- Consumers have choices to purchase foreign goods or domestically produced goods. This has compelled the domestic manufacturers to improve

the quality and reduce the prices of their products or face extinction at the hands of imported goods. The competitiveness of industry has been boosted by the unhindered availability of foreign goods.

## **V: THE IMPACT OF ISLAMIZATION ON THE FUTURE DIRECTION**

I now turn to the main theme of the conference today. The basic premise of this conference is that there are many protagonists in Pakistan who are pushing the country towards adopting an Islamic economic system. Western analysts and observers view such a move with apprehension and feel that this will lead to Pakistan's decoupling from the global economic system and its isolation from mainstream economic thinking. In their minds, such behavior will create greater instability and amplify risks for the rest of the world.

Pakistan is a moderate and progressive Islamic country that is committed to the war against extremism and terrorism and, thus, any suggestion that it will adopt policies that may be risky for the rest of the world is untenable. President Musharraf is already paying a high price in combating the menace of terrorism and extremism in the country. These policies may have short-term costs but are essential to set the country on its course of enlightened moderation.

Unfortunately, most of the assumptions and premises on which the hypotheses about the Islamic economic system have been constructed are seriously flawed. Pakistan is and will remain a responsible member of the international community and is committed to utilizing the vast opportunities provided by globalization and financial integration of world markets for the benefit of its population. There is no suggestion whatsoever by any significant group of people or political parties in favor of isolation or withdrawal from the international economic system. Secondly, the preconditions for a robust and well-functioning Islamic economic system are missing in Pakistan. The Islamic moral values that emphasize integrity, honesty, truthfulness and full disclosure and transparency are not yet widely practiced by Pakistani businesses. Once these preconditions are established the adoption of a real Islamic economic system will lead to superior welfare outcome for the majority of the Pakistani population.

How can the Islamization of the economy affect this future direction of Pakistan's economy and improve the welfare of its people compared to the

present system? The extensions that the true practice and application of an Islamic economic model can bring about will, in fact, help in overcoming the weaknesses inherent in the capitalist model of economy. Before that, let us recapitulate the basic principles upon which the Islamic economic system is built.

Unlike positive economics, the entire edifice of Islamic economics is built upon a set of objectives or *maqasid*. In other words, Islamic economics is normative in nature, with the objective of the *Shariah* being to promote the well-being of all, which lies in safeguarding their faith, their human self, their intellect, their posterity and their wealth.

At the micro level, the precepts of profit maximization and utility maximization are retained intact but are supplemented by a set of interlinked objective functions. An Islamic system tries to promote a balance between market, family, society and the state. It does so by promoting both the material and the spiritual urges of the human self, in order to foster peace of mind and enhance family and social solidarity. Some Western thinkers and anti-globalization activists decry the Western economic model as being suppressive of collective human rights and community and social well-being, disruptive of family values, and too much focused on selfish individual interests. Behavioral economists have also begun to challenge the assumption of rationality in the choices and preferences an individual makes in day-to-day life. Thus, the merit of the Islamic economic model lies in its extension of the Western model in some fundamental and beneficial ways. It introduces into the objective function an additional argument which keeps self-interest within the bounds of social interest by limiting individual preferences to conform with social priorities, and eliminating or minimizing the use of resources for purposes that frustrate the realization of the social vision. This may help promote harmony between self-interest and social interest.

This second argument complements the market mechanism by making the allocation and distribution of resources subject to a double layer of filters. It attacks the problem by first changing the behavior and preference scale in keeping with the demands of the normative goals. Claims on resources are then exposed to the second filter of market prices. In this process, the influence that initial resource endowments are able to exercise in the allocation and distribution of resources may be reduced substantially. Faith tries to accomplish this by giving self-interest a longer-term per-



spective—stretching it beyond the span of the world to the Hereafter. This interest in the Hereafter cannot be served except by fulfilling his or her social obligations. This may induce individuals to voluntarily hold their claims on resources within the limits of general well-being and thus create harmony between self-interest and social interest even when the two are in conflict.

The promotion of simple living and the reduction of wasteful and conspicuous consumption may help reduce excessive claims on resources and thereby release a greater volume of resources for need-fulfillment by others who are not so well off. It may also help promote higher savings and investment and thereby raise employment and growth.

At the macro level, the Islamic economic model in its ideal form tends to combine the positive aspects of the capitalist economy and the socialist economy while minimizing their negative consequences. A capitalist economy based on private property and market mechanisms allocates resources efficiently but as it takes initial resource endowment as given, equity considerations do not figure in this system. The socialist system is very much concerned with equity and welfare of its population and ensures benefits from cradle to grave for its citizens. But as it relies on state ownership and bureaucracy, it is poor in allocating resources, thus creating inefficiency, waste and value subtraction. The Islamic system overcomes the deficiencies of both the systems as it is solidly based on private property and the market mechanism but has also explicitly built in equity and distribution through compulsory deduction of *zakat*—i.e., transfer payments from the asset holders to the poor segments of the population. The Western economic model is criticized today as unable to address the issues of unemployment, poverty and income inequities in developing countries. The Islamic economic model addresses the distribution issues explicitly *after* the market has allocated the gains. It does so by a compulsory deduction of 2.5 percent of tangible wealth and net asset holdings from the income generated by market mechanisms for transfer among the vulnerable, sick, handicapped, indigent and poor segments of the society. Although the deduction is compulsory, the transfers are made voluntarily by the well-to-do to their poor relatives, neighbors and others whom they know to have legitimate needs. Thus the leakages, waste and corruption that are inherent in a state administered system of welfare payments are conspicuous by their absence under this system. Only really deserving

persons and families or *mustahaqeen* receive these payments. In Pakistan, it is estimated that private transfers made voluntarily to the poor account for 2 percent of GDP annually. These welfare payments are a potent force in reducing poverty, helping the vulnerable to earn their own livelihoods and lowering income disparities.

At the sectoral level, the introduction of Islamic banking should result in deepening of the financial sector. There are believers in the Islamic faith who do not use the conventional banking system because of their strongly held views that this system is based on *riba*. They will willingly deposit their savings into Islamic banks and borrow from these banks for expansion of their businesses or new investment. Thus a significant segment of the population that is currently outside the organized financial sector will be brought into its fold.

The primary principle of Islamic banking is the prohibition of *riba* (usury), which is believed to be a means of exploitation of the masses. Trade is the preferred mode of business in Islam. The goal of banking is the general economic improvement of the public at large rather than of a few groups.

What are the characteristics of the Islamic bank?

- One of the most distinguishing features of Islamic banking is that being part of a faith-based system, it is obligatory on Islamic banks not to pursue activities that are detrimental to the society and its moral values. Thus Islamic banks are not allowed to invest in casinos, nightclubs and breweries, etc. It is pertinent to note that casinos are one of the prime vehicles used for money laundering, and dealing with them could expose the conventional banks to such risk.
- The second distinguishing feature of Islamic banking is that, in addition to the rules and regulations applicable to the conventional banks, the Islamic banks have to go through another test—i.e., fulfill exhaustive requirements to be *Shariah*-compliant. This requires that the clients of Islamic banking must have business that should be socially beneficial, creating real wealth and adding value to the economy rather than making paper transactions. Therefore, a stringent “Know Your Customer” (KYC) policy is inherently an inbuilt requirement for an Islamic bank, since the Islamic bank has to know the customer and his business before getting

into a socially responsible *Shariah*-compliant transaction. KYC is the first line of defense against money laundering in any banking system.

- Third, by their very nature, Islamic modes of financing and deposit-taking discourage questionable/undisclosed means of wealth that form the basis of money laundering operations. The disclosure standards are stringent because the Islamic banks require the customers to divulge the origins of their funds in order to ensure that they are not derived from un-Islamic means—e.g., drug trading, gambling, extortion, subversive activities or other criminal offences. On the financing side, the Islamic banks must ensure that funds are directed towards identifiable and acceptable productive activities. Most Islamic financing modes are asset backed—i.e., they are used to finance specific physical assets like machinery, inventory, and equipment.
- Fourth, the role of the bank is not limited to a passive financier concerned only with timely interest payments and loan recovery. The bank is a partner in trade and has to concern itself with the nature of the business and profitability position of its clients. In the case of loss in business, the Islamic financier has to share that loss. To avoid the loss and reputational risk, Islamic banks have to be extra-vigilant about their clientele.

To sum up, it can be said that banks that judiciously follow Islamic banking principles are less likely to engage in illegal activities such as money laundering and financing of terrorism than conventional banks. However, the existence of rogue elements cannot be ruled out in any type of organization. It is the duty of the state and the regulators to ensure that despite these built-in safeguards, there are adequate pieces of legislation, regulations, and enforcement mechanisms to take action against the potential offenders.

Pakistan has taken a policy decision that it will allow both the conventional and Islamic banking systems to operate in parallel. The choice will be left to the consumers whether they wish to migrate from the conventional to the Islamic system or stay with the conventional system. The State Bank of Pakistan has a transparent system of licensing, regulating and supervising the Islamic banks in Pakistan. There are three ways in which this type of banking can be set up: (a) a stand-alone exclusive

Islamic bank; (b) existing conventional banks establishing a subsidiary; or (c) earmarking some of their branches for Islamic banking. A *Shariah* Board consisting of scholars, economists, accountants and bankers will determine whether the products and services offered by these institutions are compliant with *Shariah* or not.

The MMA Government in NWFP has earmarked one of the branches of a provincial government-owned bank as an Islamic bank, and only on the basis of the experience gained will they gradually move to convert other branches to this mode. You can therefore see that, contrary to the alarmists' cries, the provincial government has been extremely prudent and responsible in moving gradually in this direction. It has fulfilled all the standard requirements which the Central Bank had stipulated, and no exception was made in granting the license for this branch. Business and commercial considerations will determine the future evolution of Islamic banking in the province.

To sum up, Islamization, if adopted and practiced in its true form at any time in the future, will strengthen the economy, particularly income distribution and poverty alleviation, which have proved elusive under the present economic model. This will, in fact, eliminate the sources of instability, violence and propensity towards terrorism arising from a sense of deprivation.

## **VI: ECONOMIC PROSPECTS IN THE MEDIUM TERM**

As the full-fledged operation of a true Islamic economic system in any of the Muslim countries and particularly Pakistan is far from realization in the near future, only gradual and slow changes will take place. Thus, the burning issues of poverty, income distribution and unemployment will remain to preoccupy the attention of economic managers and policymakers, as the remedies available under the Islamic economic system to resolve them are unlikely to be applied. Under this scenario, what does the future hold for the Pakistani economy, and what are the prospects for addressing these issues?

Empirical evidence from the history of Pakistan suggests that there is a direct relationship between rapid economic growth and poverty reduction. After the annual economic growth rate crosses the threshold of 6 percent or more on a sustained basis, there is a strong probability that the incidence of poverty will begin to decline.

There is little doubt that GDP growth rate can recover to the historic levels of an average of 6 percent or more, provided structural reforms are continued and further deepened, productivity gains in agriculture are achieved, and a set of non-economic factors including governance are put in place. This will not only reduce the incidence of poverty but also unemployment and, to some extent, regional disparities. It is also projected that the inflation rate will remain contained within the 6–8 percent range, provided appropriate monetary and fiscal policies are followed. The latter are geared to bring the budgetary deficit down to 3 percent of GDP in the next three years, increase the tax-GDP ratio to over 15 percent, contain the growth in non-development expenditure and raise the share of social and poverty-oriented programs.

What is the agenda for getting back on this trajectory? The realization of the projections outlined above will depend upon the interplay of evolution in political and social developments, economic policies to be pursued, the quality of governance and institutions, the external environment, and most important, investment in human development. It has become quite obvious from both Pakistan's own history and the experience of other developing countries that sustained economic growth and poverty reduction cannot take place merely on the strength of good economic policies. Political stability, social cohesion, supporting institutions, and good governance are equally important ingredients, coupled with a benign external environment, for achieving economic success. The economy will suffer from temporary shocks, both domestic and externally induced, but will develop resilience to tolerate these shocks with minimum disruption and dislocation if these ingredients are present. So what do essential ingredients for transforming the Pakistani economy entail? What are the pillars on which the foundations of Pakistan's rapid economic development will be built in the future?

Pakistan's checkered and uneven record on political instability and lack of democracy has deprived the country of a long-term vision, direction and continuity of economic policies. The rapid turnover of governments and the actual and imminent threat of the dismissal of governments through extra-constitutional means have certainly proved to be inhibitors to investment, innovation and institutional development. Democracy in Pakistan is still interpreted in a fairly narrow sense—i.e., holding general elections and allowing political parties to compete.

While this is necessary, other pre-requisites of a well-functioning democracy—e.g., rule of law, civil liberties, freedom of expression, checks and balances on the powers of different organs of state, and religion and ethnic tolerance—have not yet taken root. Parliamentary elections are not meant to provide license to those elected to rise above the law and do whatever pleases them. Separation between executive and legislature, with the latter exercising effective controls on the former, is still missing due to the entrustment of executive powers to the ruling party in the legislature. As there is no other countervailing mechanism, excesses committed by the executive have only been corrected by dismissals or extra-constitutional measures. These extraordinary steps create uncertainty and unpredictability, which are inimical to long-term economic growth. Thus an effective watchdog legislature and a vigilant judiciary-enforcing rule of law that includes enforcement of contracts and protection of private property will obviate the need for frequent changes in the government. Political parties themselves have to shift the emphasis on dialogue to broad-based strong growth rather than narrow-minded slang and personality-oriented cults. A stable and orderly political system ingrained and practicing all the elements of democracy is the first pillar for transforming the economy.

Although democracy does mediate between different ethnic, religious and regional groups, Pakistan has witnessed growing polarization and division along sectarian, ethnic, linguistic, and cultural lines in the decade of the 1990s, particularly after the defeat of the Soviet forces in Afghanistan. Social capital, which is a glue for fostering economic development, has been depleting. Although Islam teaches us tolerance and harmony, the violent sectarian killings and the consequential law and order problems need to be curbed effectively. Social cohesion, trust, tolerance and inter-provincial harmony on the back of a truly participatory and well functioning democracy, a vibrant civil society and a shared sense of fair play in allocation of national resources are the second pillar for robust economic transformation.

Recent empirical evidence and common sense strongly suggest that sound economic policies cannot make any difference to the lives of the common citizens if the country does not have strong institutions to implement those policies. Pakistan had inherited a strong civil service, judiciary, and police, which could meet the demands of thirty million

people. But as population expanded and the nature of problems became more complex, the capacity of these institutions did not keep pace with the emerging demands of the economy. On the contrary, these institutions were politicized and captured by a small elite group to serve their own narrow interests and those of their masters. The consideration of the common good was replaced by self-aggrandizement, and the process of institutional decay crept in and gradually eroded the foundations of most of these institutions. These dysfunctional institutions were unable to deliver basic services to ordinary citizens.

Crude estimates suggest that if institutions and the legal system were working well, Pakistan's GDP would grow by at least two percentage points faster—if the land titles were clear, actively traded, mortgaged and exchanged without much hassle. If tax assessment, the tax code and tax collection methods were simplified, made less arbitrary and free from discretion of tax officials, the tax base would be much wider and the tax-GDP ratio much higher. If the court system were unclogged, the enforcement of contracts would be quicker and reduce transaction costs substantially.

The fourth pillar is good governance. There is an overlap between the other three pillars described above and good governance. Rule of law, transparency, and predictability are the essential elements of good governance. Authoritarian governments have a relatively better record of governance in Pakistan, but these gains have proved to be short lived. Only democratic governments with clear rules of transition and strong functioning institutions can provide the platform for embedding good governance in the work ethic. It has to be demonstrated during the next five years that democracy and good governance are not mutually incompatible, that a democratically elected government can also serve collective interests in contrast to its personal interests, and that the quality of governance can be better. The interplay of voice and accountability, civil liberties and free media, which form the core of democracy, reinforce the quality of governance.

Three recent steps—devolution of powers to local governments, the National Anti-Corruption Strategy and National Accountability Bureau, and encouragement of private-public-community partnerships—will fill in the missing gaps in effective implementation of governance.

The devolution of powers to local governments since 2001 is undergoing a phase of consolidation and is facing some teething problems. But this

devolution has a built-in capacity to respond to the demands of the common man for obtaining basic services such as security, education, health, water supply, and sanitation. This system is facing fierce resistance from all those groups who had vested interests in the old centralized, highly personalized top-down system of administration. The system needs to be carefully nurtured and monitored, and its structural and operational deficiencies and weaknesses removed, but any attempt to dislodge it or make it impotent will adversely affect the access of the poor and disenfranchised to public expenditures and public goods.

Finally, most important among all the factors that will impinge upon the future shape of Pakistan's economy is accelerated investment in human development. In fact, underdevelopment of human capital is the most daunting challenge facing Pakistan. High population growth—one of the fastest in the world—has given rise to a young dependent population and increased unemployment among youth. One-half of the population is illiterate, making it more difficult to impart new skills to the ever-burgeoning labor force. The average years of schooling remains quite low. Investment in higher education, science and research has been almost insignificant and has hurt the competitiveness of Pakistani firms in world markets. Low levels of female education and literacy have made one-half of the population less than adequately prepared to participate in the domestic labor markets and deprived the country of many externalities that arise from a literate female population.

A comprehensive package of educational sector reforms, a medium-term health strategy, fiscal restructuring and devolution of administrative and financial powers to local government, public-private partnership in delivery of social services, and community involvement and participation are some of the items that need to be put in practice with full commitment.

The above survey of Pakistan's past, present and future should reassure the Western community that if and when Islamization of the economy takes place, it will not pose a threat to Pakistan's journey towards stability, growth and poverty reduction. Along with good policies, good governance and good luck, it will create conditions that are conducive for growth and poverty reduction. Pakistan is very much, and will remain, integrated into the world economy and fully utilizing the opportunities thrown open by globalization to benefit its population.



## Islamizing the Economy: The Pakistan Experience

KHURSHID AHMAD

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I am extremely grateful to the Woodrow Wilson Center for providing all of us with an opportunity to share with each other reflections on certain key concepts of Islamic economy and salient aspects of the Pakistani experience, in the context of their implications for the world economy.

Islamic economics, although rooted in the values, principles and commands contained in the Quran and Sunnah, is neither a branch of theology (*Kalam*) nor of law (*Fiqh*). It represents an *approach* to the fundamental questions of economics—i.e., what is to be produced, how is it to be shared, and what is to be the shape of final consumption in a society?

Man's economic problem is as old as are humans on the earth. While economics as a social science has been developed only during the last two centuries, the economic problem has always been there. Humans, in all times and climes, have strived to grapple with the economic problems at conceptual as well as practical levels in different civilizational contexts.

Islamic economics is a nascent yet evolving discipline. It represents a fresh approach to economics and the economic problems of mankind.

Economic discipline and economic policy as they have developed in the West during the last two hundred years pose certain problems. All economic relationships have two dimensions: one technical, which relates to the physical or positive laws of production and consumption; and the other normative and ideological. The two are intertwined. Wherever there is a question of choice, there has to be a moral dimension. Choice can be motivated by physical and positive considerations, but choice is also influenced by our moral values and normative considerations. Over the years, economic science, even policy formulation to a certain extent, has witnessed what I call a de-linking between the positive and the normative dimensions. The founding fathers had developed their conceptual framework on certain moral and ethical assumptions, sometimes explicit, often implicit. Over the years the separation between ethics and economics has been accentuated with far-reaching consequences for the theory and practice of economics.

A second development relates to separation between economics and other social disciplines. Gradually economics tried to become a self-contained social discipline, parting ways with its integral linkage with politics, sociology, psychology and other disciplines. Obsessed by the idea of making economics a more and more positive science, an eagerness to introduce quantitative methodologies of physical sciences, particularly mathematics, is partially responsible for this de-linking from other social sciences.

Thirdly, the pursuit of efficiency and optimal allocation of resources became the central problem of economics. Efficiency is a very important concern, but over the years, considerations of efficiency have become so dominant that the equally important dimensions of equity and justice and of social and ecological consequences of economic efforts became eclipsed. Issues of distributive justice, quality of life and sustained growth were marginalized. Consequently the link between wealth and well-being was drastically weakened if not totally severed.

Finally money, which was primarily a medium of exchange, a measure of value and a powerful instrument for financial intermediation, became an objective in itself. The institution of interest played a crucial role in this transformation. Consequently, the critical link between money and the physical economy was thinned out. Money became a commodity. An

expanding fiduciary space emerged, which has ballooned ever since, occupying a central realm in the world economy. To give just one example: foreign exchange is primarily an instrument for facilitation of international trade and exchange of services. Yet presently, daily turnover in foreign exchange in global markets is more than 50 times that of total volume of international trade. The make-believe world of derivatives has overtaken the physical economy.

These four major de-links have transformed economics. Efficiency and equity in the world economy no longer go hand in hand. While global production has increased exponentially, economic miseries of almost two-thirds of humanity remain unrelieved. Almost 87 percent of the world GDP is concentrated in the hands of less than 20 percent of the world population in developed countries, even if gross inequalities within the developed world are ignored. The world is becoming more and more inequitable. The ratio of wealth between the rich one-fifth and the poor four-fifths of the world was 30:1 in 1950, which increased to 60:1 by 1980 and at the advent of the 21st century it had roared to 85:1. Yet people all over the world, and countries rich and poor, are groaning under ever-increasing mountains of debt. The United States, the richest country of the world, is also the most indebted country on the globe. And there is the plight of the poor. At the advent of the 21st century all are faced with an explosive situation.

The predicament in which we find ourselves is, among others, a result of these four major de-links. Islamic economics represents an effort to search for a new paradigm. We are not seeking some changes within the economic paradigm of capitalism, which is the dominant system. The effort is aimed at paradigm change. The idea is to address basic economic problems from a moral and socially responsible perspective. We seek to reintegrate economics with ethics. Efficiency and equity become elements of a composite reality. Instead of a piecemeal, incremental approach, our approach is more holistic, integrated and all-embracing. We want to refocus on growth involving production of useful goods and services and on asset creation, as against financial ballooning. Productive efficiency and distributive justice are twin objectives, inalienable elements of an integrated whole. This, broadly, is the roadmap to a new paradigm.

While abolition of interest and introduction of *zakat* are two pillars of the Islamic economic system, Islamic economics represents much more

than that. It represents a new approach to economics, including resort to some new methodologies to come to grips with the eternal issues of the economy: what is to be produced? How is it to be distributed? And how would it be consumed?

Let us not forget that the right of private property, freedom of enterprise, the market mechanism and the profit motive predate capitalism. While capitalism built its system on the foundations of self-interest—private enterprise, markets and profit—its unique contribution lies in giving them a particular shape and role. They are not unique to capitalism. Private property and enterprise, self-interest, the market mechanism and competition are integral to the Islamic economic system. Yet their distinct character and role are fashioned by the value framework of Islam. The individual is the building block of the society and private enterprise is a premium mobile of the system. Yet property rights, legal and sacrosanct, have a dimension of social responsibility. A fundamental Islamic concept is that property, power, and authority—at all levels including state authority—are in the nature of trust. Within the framework of this relationship of trust there are clearly defined lines and limits of rights and obligations.

As such, moral and social dimensions are integral to the reality of individual rights. In fact, rights and duties represent two sides of the same coin. Competition and cooperation go hand in hand. Market mechanisms operate in the context of different sets of moral filters and societal and legal regulatory mechanisms. The state is neither the police state of the liberal democratic model, nor a totalitarian entity of the socialistic brand. Primarily, its function is to maintain law and order, ensure national security and provide a congenial regulatory environment for civil society and the economy to operate and prosper. But establishment of justice is also an overriding function. This is so not merely in the sense of legal justice, but also concern for and commitment to political, social and economic justice. The state has a more positive role to play, without suppressing individual liberties, participatory processes and the democratic character of the society, economy and polity. Self-interest is hedged by moral concerns. Freedom goes with social responsibility, competition is complemented with cooperation, and efficiency with justice. This is our vision of an economy and this concept has relevance not only to Pakistan and the Muslim world, but to human society anywhere in the world. The issues of property rights, intellectual propriety, competition, self-interest, efficiency,

profit, growth and accountability are our common concern. So are questions of justice and well-being. There are certain similarities between the Islamic and the capitalistic order. There are equally important dissimilarities and divergences. It is the unique ethos of Islam as that of liberal capitalism that defines the role and character of these fundamental concepts, in the two geo-economic profiles.

Islamic economics is not isolationist and autarkic. It has a universal relevance. There is trade-off with other systems. There could be diversity within the Muslim countries and between the Muslim world and the rest of the world, despite areas of agreement and disagreement and convergence and divergence. International trade, movement of capital and investment, and ever-increasing economic and financial relationships between individuals, groups and states at the regional and global levels are integral to the Islamic system. Of course there are certain areas where readjustments and realignments would be needed, particularly because of the Islamic sensitivity with respect to interest and ethical investment. But it should be clear that the Islamic agenda for eliminating interest does not involve any denial of profitability of capital or its right to enjoy a just return. What is disputed is a predetermined fixed return on capital, without sharing the risks of enterprise. Capital is entitled to a return based on its actual productivity. While facilities for credit are not denied, an Islamic economy is primarily an equity-based economy and not a debt-based one. It is a sharing and stake-taking economy. Equitable sharing is as important to the Islamic milieu as efficient production.

As to the Pakistan situation, the concept of Islamic economics is an essential part of the very concept of Pakistan. The Objectives Resolution passed by the Constituent Assembly of Pakistan in 1949 and the Constitution of Pakistan contain essential elements of the vision of Islamic economics. However, very little effort was made to actualize this vision, particularly in the public sector. It was during General Zia ul-Haq's period that some piecemeal and disjointed efforts were made in that direction. That process too did not go far enough. Most of the changes were only ornamental. That is why they could not bring any substantial change in the system. In the private sector, however, a number of pioneering efforts have been made to bring economic relationships into harmony with Islamic values. Many enterprises and institutions have tried to switch over to equity finance. There are quite a few cases of success stories in the private sec-

tor. In the fields of education, social services and poverty alleviation too, the private sector has made distinct contributions. To give an example the allocation in the federal budget for social services is almost negligible—less than 0.8 percent of the GDP for health care and only 1.8 percent for education. However it is through private philanthropy that over 70 billion rupees per year are provided for these support networks. This is equal to almost one-tenth of the total federal budget, of which 50 percent goes away in payment of interest on external and domestic debts and almost 30 percent is spent on defense. People are surviving because of private philanthropy. There is no nationwide state-based system of social security.

The Supreme Court judgment of 1999 and, before that, the judgment of the Federal Shariah Court of 1991 on elimination of *riba* are important documents, but they have failed to make any real dent in the system. Their implementation is still far off. However, the State Bank of Pakistan has taken some serious initiatives in the recent past and there is an increasing response from the financial and business sectors. This becomes all the more important in the context of the Islamic revivalist movement in the country. A number of Islamic banks or Islamic banking branches of conventional banks have been established during the last three years. It is too early to evaluate their performance. The possibilities of success are bright. It may be recalled that the global Islamic banking movement gained strength when the first Islamic bank in the private sector was established in Dubai in 1975. The Islamic Development Bank, Jeddah, was also established in the same year at the initiative of the governments of the Muslim countries. Presently there are over 300 Islamic banking institutions operating in some 40 countries of the world. The asset base of these banks is around 250 billion dollars and their deposits and advances exceed 300 billion dollars. The overall performance of these Islamic banks is generally regarded as positive and encouraging. Most of these banks operate in the private sector, some with limited government or institutional participation. Iran and Sudan have made some efforts to change the entire financial and banking system through state-sponsored change, but with limited success. However, in the private sector the rate of growth of Islamic banks is three to five times higher than the rate of expansion of conventional banking. Being newcomers, the rate was expected to be faster because of the low base, but the fact that they have competed successfully with established conventional banking and have

carved out a significant space for themselves, both by partly taking over from conventional banking and partly creating a new market, goes to their credit. A number of new financial products have evolved. *Shariah*-compatible trading and financial organizations are on the increase. There is an emerging Islamic capital market. Redesigning of accounting and auditing practices is taking place. Ever-expanding efforts towards dialogue, discussion, research and experimentation represent a very positive development and hold promise for the future.

It is mainly in the private sector that Islamic banking has made some substantial progress in Pakistan, Kuwait, Malaysia, UAE, Bangladesh and others. Every Muslim country has its own model, despite many similarities and commonalities. The Islamic Development Bank is playing an important role in promoting Islamic banking in the world. As to Saudi Arabia in my view, Islamic banking remains a less developed sector. While interest-based contracts cannot be enforced through the courts of law, the banking system, by and large, is operating on the basis of interest. One major bank and interest-free windows in some other banks have appeared during the last decade. At the theoretical level a lot of work is being done on this subject. There is a heightened interest by the public and professionals through exchange of ideas and experiences via conferences, seminars and visits. There is no central Islamic bank so far, although the Islamic Development Bank has played an important role in promoting interaction between Islamic banks worldwide.

As I have said earlier, elimination of interest and promotion of *zakat* is only one aspect of the Islamic economy. Similarly *zakat* in most of the Muslim countries is instrumental in providing some kind of a social security net to the underprivileged classes. The effort to reform or restructure the economies of the Muslim world is still in an early phase. The objectives of an Islamic economy are now more widely acknowledged. These objectives primarily are strengthening the moral fiber of the individual and the society (*taqwa*), and ensuring provision of *adl* (justice) and *ehsan* (benevolence) for all human beings.

Finally, our vision of Islamic economics is one where on the one hand Muslim people should have an opportunity to order their economic life in accordance with moral and social ideals of Islam, but on the other they are equally eager to promote cooperation and co-existence with the rest of the world, wherein every people should be equally entitled to establish

its economy according to its own values and vision. We firmly believe that competition is important not merely within a given economic system but also between economic systems. This is important for the progress and well-being of humanity. Hegemony of any one system throughout the entire world cannot but signal the “end of history,” as progress comes from diversity, healthy competition and cooperation among the nations.

Robert Fogel, winner of the 1993 Nobel Prize for economics, says in his recent book *The Fourth Great Awakening and the Future of Egalitarianism*:

*At the dawn of the new millennium the critical issues are no longer whether we can manage business cycles or whether the economy is likely to grow at a satisfactory rate. It is not even whether we can grow without sacrificing the egalitarian advances of the past century. Although the consolidation of past gains cannot be ignored, the future of egalitarianism in America rests on the nation's ability to combine continued economic growth with an entirely new set of egalitarian reforms that adhere to the urgent spiritual needs of our age, secular as well sacred. Spiritual (or immaterial) inequity is now as great a problem as material inequity, perhaps even greater.*

John Gray, a British economist, in his book *False Dawn: the Dimension of Global Capitalism* makes an important observation on which I would like to conclude my presentation:

*A reform of the world economy is needed that accepts a diversity of cultural regimes and market economies as a permanent reality. A global free market belongs to a world in which Western hegemony seemed assured. Like all other variants of Enlightenment Utopia of a universal civilization it presupposes Western supremacy. It does not agree with a pluralist world.... It does not meet the needs of a time in which Western institutions and values are no longer universally authoritative. It does not allow the world's manifold cultures to achieve modernizations that are adapted to their histories, circumstances and distinctive needs.*



## Islamization and Private Enterprise: Can the Two Work Together?

SHAHID JAVED BURKI

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Those who are familiar with the subjects of Islamic economics, Islamic finance and Islamic banking know that the real push in these areas came in the late 1970s. There is a consensus among Islamic historians that the real pressures to bring Islam into economics and finance came after the enormous increase in income and wealth of Saudi Arabia and the Gulf States following the sharp rise in the price of oil in 1973 and again in 1979. The Saudi Kingdom was prepared to use its newly developed economic muscle to promote its interpretation of Islam in the rest of the Muslim world, particularly in the way the countries in this area managed their economies and institutions of finance.

One development, more than any other, prompted the Islamization of the economies in Muslim countries—the establishment of the Islamic Development Bank (IDB). The IDB was founded in 1975,<sup>1</sup> following a resolution passed by the Organization of Islamic Conference (OIC). The

OIC itself got a new lease of life with the infusion of some petro-dollars into its coffers. It acquired a number of new members who looked to the IDB as a financial intermediary between them and the cash-rich oil exporting countries. Based in Jeddah, the IDB's principal function was to promote development and alleviate poverty in the Muslim world's poor countries. Since this was to be an Islamic institution, it could not adopt the working procedures of other multilateral development banks such as the World Bank and the Asian Development Bank.

There were two traditional ways of providing development finance from multilateral development banks (MDBs). One was to receive grants from rich member countries and pass them on highly concessional terms to those that were relatively poor. The MDBs provided very little grant money themselves. The other was to go to the capital markets and use the better credit rating of the agencies to raise finance. The amounts mobilized were given out as loans at the rates the recipients could not have managed even if they could access the capital markets. In either case, loans and credits were provided at a defined rate of interest. This was not possible for the IDB, given the Islamic injunctions against interest. The Bank, therefore, had to find some other way of providing assistance to its poor members. It was this search for Islamic lines of product that gave push to the development of Islamic finance in the Muslim world.

This essay will look at the impact of Islamization on private enterprise in Pakistan. But first, let us address the suggestion that the Islamization of the Pakistani economy has proceeded far enough to begin to affect private enterprise and private entrepreneurship. This is not the case in Pakistan. In Islamizing the economy and its financial system, Pakistan has still to travel a long distance before private enterprise begins to be affected positively or negatively in a meaningful way.

That said, it would be useful to provide some background on the forces that are lending some dynamism to the Islamization effort in Pakistan. It would also be useful to say a word or two about the state of play in the country at this time. Accordingly, I will divide this presentation into three parts.

- One, why Pakistan waited until the late 1970s to bring Islamic principles into economic management and why the effort has proceeded unevenly in fits and starts.

- Two, how far has Pakistan gone in Islamizing its economy over the last quarter century.
- Three, how far is Pakistan likely to go towards the goal of Islamization as related to economics, in particular to the evolution of the financial sector.

As for how private enterprise is likely to be affected by Islamization as it has already occurred and is likely to occur in the future, I have already offered my conclusion.

### **REASONS FOR PAKISTANI INTEREST IN ISLAMIC FINANCE**

Pakistan waited for more than three decades before the country's policymakers showed some interest in Islamizing the economy. This is surprising since it was the pursuit of an ideology that resulted in the creation of Pakistan as an independent state. A country carved out as a homeland for the Muslims living in British India could have been expected to order their lives according to the dictates of Islam. This did not happen for the simple reason that a vast majority of the new country's population believed—without explicitly stating this view—that the state and religion did not need to mix, and if made to mix they would not work well together.

That notwithstanding, a concerted attempt was made by a small group of Islamists in the 1950s to have Islam influence the make-up of the political system. That effort did not produce a tangible output other than the preamble to the country's first constitution adopted in 1956.<sup>2</sup> Progress in the political and economic areas insofar as Islamization was concerned had to wait for another three decades after the country gained independence. The push towards Islamization was felt only in the late 1970s after some of the forces looking to bring about change were able to coalesce. What were these forces and how much change did they bring about?

It would be useful, therefore, to identify the main sources of the pushes and pulls that have been felt in the area of Islamization not only in Pakistan but in the entire Muslim world. Most countries and people have responded to one or more of the following four sources of demand for the Islamization of the economy:

- One, leaders or leadership groups within the countries that pushed for Islamization.
- Two, people with strong beliefs in the Islamic system who were in search of instruments of savings and finance that complied with the teaching of Islam. In other words, the development of a market that demanded Islamic products.
- Three, large external donors who were prepared to provide assistance only or primarily on the basis of Islamic principles.
- Four, the Muslim diasporas, some members of which wanted to invest their sizeable savings only in Islamic instruments and lines of Islamic products.

In the case of Pakistan, at least in the initial phase of the development of Islamic finance, impetus came from a combination of outside persuasion and the commitment of strong leaders. As already noted, it was the combined pressure from Saudi Arabia and the Islamic Development Bank that were the principal motives for the first few initiatives taken by the government in Pakistan. It needed the additional reinforcement provided by General Zia ul-Haq, Pakistan's third military leader and a devout Muslim, to set the stage for Pakistan's tentative move into the field of Islamic economics. One European historian of some repute has suggested that even in the case of President Zia, political expediency overrode piety in motivating action to Islamize the economy. According to Gilles Keppel, "...in Pakistan, Islamization served to associate devout bourgeoisie and Islamic intellectuals with a system that allowed the governing elites to remain in the form of a military hierarchy. More significantly, it prevented the masses from rebelling in the name of Allah."<sup>3</sup> Among the several initiatives taken by the Zia government, two had a lasting effect on the country's economy. Those included the introduction of *zakat*, or wealth tax, and the Islamization of the banks.

In more recent times, Pakistanis and other Muslims resident abroad have begun to look for Islamic products in their homelands in which to make investments. The Pakistani diasporas spread over three continents—the Middle East, Europe and North America—have large incomes and savings and are rapidly building their wealth in the countries in which

they live. I have estimated elsewhere that the combined annual income of the four million Pakistanis living abroad is about the same as the gross domestic product of their homeland. The rate of savings among the diaspora Pakistanis is about twice as high compared to the proportion of income saved by their counterparts living in Pakistan. These savings used to go into housing and small businesses; significantly larger amounts are now being committed to building financial assets. However, with a sharp decline in returns available in North America and Europe, the holders of assets abroad among the Pakistani diasporas have now begun to look at investment opportunities back at home.

There are other pressures also at work which are increasing attraction of the diaspora members for investing in Pakistan. Some Islamic products developed by the Muslim communities in America and Europe have recently come under official scrutiny and pressure, especially by the U.S. authorities. The crackdown by the U.S. administration on Islamic charities and financial institutions has had a chilling effect on the development of Islamic finance in the West, particularly in America. Feeling these constraints the diasporas are turning increasingly towards Pakistan, hoping to find instruments structured on Islamic principles into which they can plough their ample savings.

I don't wish to suggest that the number of people among the diasporas with an active interest in Islamic finance and the amount of savings available to them are so large that they will exert a profound influence on the pace of development of Islamic banking and finance in Pakistan. There are no hard numbers available in this little-researched and analyzed area. But the amount of funds that are looking for Islamic products is large enough to have some prominent Western banks—HSBC, based in London, and Citigroup, operating out of New York, for example—to invest time and resources to develop the lines of Islamic products. From the data provided by these institutions it would appear that there are now sizeable amounts placed in them by the members of the Muslim community residing in Britain and North America.

The point of this discussion about the sources of pressure being exerted on the Pakistani financial system to move towards Islamization is to draw an important conclusion: that these pressures are coming from external sources (Saudi Arabia, the IDB, the Muslim diasporas) but no longer from the leadership or the Islamabad-based establishment (as they did dur-

ing the periods of rule by President Zia ul-Haq and Prime Minister Nawaz Sharif). There is no palpable pressure from the domestic market made up of hundreds of thousands of individual and household savers and tens of thousands of investors. This may be a controversial statement to make, but I don't believe that in the Pakistani population there is an overwhelming desire to move towards an Islamization of the economy.

There are many in the country who would want such a system to develop, but their proportion in the population is not very significant—certainly less significant than is the case in Saudi Arabia, the Gulf States, Iran and possibly also in Turkey. After all, and notwithstanding the relative electoral success of the Islamic parties assembled under the banner of the MMA, the support for both political and economic Islam has never been more than ten percent of the population. Whether this proportion will grow will depend upon a number of factors, including the conduct of the U.S.-led war on terrorism and political developments in Afghanistan and Iraq. For the moment, it is safe to conclude that the domestic pressures for moving the economy towards Islamization are not likely to bring about brisk and palpable change.

## **THE PACE OF ISLAMIZATION**

It is for the reasons cited above that Pakistan has not moved quickly towards economic and financial Islamization. Any change thrust from above—by external donors or by foreign investors or by leaders with little broad support, as was the case in Pakistan—will not throw deep roots into the economy. That will only happen if there is a strong domestic demand for bringing about such a change. This is the reason why Pakistan's efforts to date have been, at best, half-hearted.

To say—or claim—that Pakistan is today operating a hybrid system of finance and economics which has incorporated all those principles of Islam that can be introduced without producing serious disruption would be too generous an interpretation of what exists today. Malaysia is probably the country that has made the most serious advance in developing parallel and functioning systems. Bahrain is another country that has moved in the same direction. In Pakistan during the periods of President Zia ul-Haq and Prime Minister Nawaz, an effort was made to radically Islamize the banking system. But a sense of pragmatism prevailed over

piety and only cosmetic attempts were made by the banking system to conform to the edicts issued from Islamabad.

Commercial banks changed their interest-bearing accounts into profit-and-loss accounts in which profits were still determined ex ante and at a pre-determined rate. According to a strict interpretation of Islamic economic principles, this conversion did not produce an Islamic banking system. Disappointment that the country was not moving fast enough led to an effort by some Islamists to force compliance through the use of the judicial system. The legal system, as a result of President Zia's intervention, had itself become a hybrid—an uneasy marriage had been forced between western jurisprudence and *Sharia*.

In a long and closely argued judgment issued by the *Sharia* bench of the Supreme Court, the government was provided a strict timeline for the introduction of the Islamic system in banking and finance. By the time the bench issued its judgment, the Islamabad establishment was under the control of more secular-minded people. Forced to confront the issue, Islamabad chose not to directly seek judicial review of the timeline provided by the judges to Islamize the financial system. Instead, the authorities persuaded one of the commercial banks operating in the public sector to file a case based on the practicality of implementing the judicial injunction. The judiciary obliged and allowed the government to re-examine the issue once again. As Ishrat Husain, Governor of the State Bank, writes in a recent book, “the government of Pakistan and the State Bank are fully committed to implementing the decision of the Supreme Court for transforming the economy according to the precepts of *Sharia*. To this effect, the Commission on Transformation of Economy at the State Bank, and the Task Forces in the Ministries of Law and Finance have made some recommendations...To achieve a smooth, orderly and gradual transition towards an Islamic financial system, a clear road map has been developed, which allows the conventional and the Islamic system to run parallel to each other, without severe disruption or dislocation of the present system.”<sup>4</sup>

Translated, this statement by the State Bank governor says the following: one, today's authorities in Islamabad do not feel they have the political strength to put on hold the efforts to radically Islamize the economy. It is politically not feasible to pull back entirely from the announced intentions of such earlier rulers as Zia ul-Haq and Nawaz Sharif. Two, that notwith-

standing, the type of radical transformation of the economic system in general and the banking system in particular would be too disruptive for the economy. The Zia-Sharif-*Sharia* bench visions are not practical in Pakistan's circumstances. Three, it is possible to put in place a parallel rather than a total or even a hybrid system. That is the direction in which Pakistan will move. Four, it would take time even for such a system to evolve.

What the governor didn't say was that the functioning of even a parallel system would require some significant changes in the accounting and banking supervision framework as well as the way the country manages its monetary policies. In a well-researched *Anthology of Islamic Banking* issued by a London-based institution, a number of experts identified the changes that must occur in the policy environment in which Islamic banking and finance must operate for it to become viable. As Mohsin Khan, a senior IMF official and one of the contributors to this volume puts it, "Islamic banks operating in a modern economy also face their own particular set of problems. These need to be addressed if Islamic banking is to reach a level that would place it on par with conventional interest-based banking... Obviously [for this to happen] will require considerable research and experimentation—but it is an agenda that will need to be addressed if Islamic banks are to prosper and take an increasingly important role in financial transactions in [this] century."<sup>5</sup>

## ISLAMIZATION'S FUTURE IN PAKISTAN

Having set itself on a course that would gradually and pragmatically introduce Islamization into the economy, how far is Pakistan likely to go? Gazing into the future is always difficult, particularly when the future depends on the factors that come bound with a great amount of emotion. With this caveat in place, I am prepared to make the following predictions.

**One**, the evolution of new political systems in countries such as Afghanistan and Iraq will tie Islam much more closely with governance in Muslim societies. In other words, the systems that will evolve in these countries will run counter to the series of assumptions made by the U.S. neo-conservatives as they forced regime and political change on some parts of the Muslim world. They had to see Muslim political systems to be built upon the principles of western democratic liberalism. Instead they are likely to see an infusion of Islam and politics and economics.



It appears at this point—and in large part because of the way the attempts to democratize Iraq’s political system are currently unfolding—that Islam will enter the democratic political and market-based economic systems being designed under American influence in some parts of the Arab world. If America’s Iraq project succeeds, the forces of Islam—the only ones that have some organization behind them and have an aura of legitimacy—will ensure that economic and political Islams are not separated from the marketplace and from governance. This will set a pattern and will be of great consequence for the rest of the Muslim world.

**Two**, the U.S.-led war on international terrorism may lead to a perception in many parts of the Muslim world that this is, in effect, a war on Islam. If this perception continues to grow, it is bound to lead to a political reaction. That in turn will see considerable strengthening of the Islamic parties in the parts of the Muslim world—and this includes almost all Arab countries—where political institutions are weak.

**Three**, in the rest of the Muslim world—that is to say in non-Arab countries in the world of Islam—the rise of Islamic parties will be balanced by the growing strength of more secular-minded political groups which are likely to become more assertive faced with the fear that unchallenged Islamic parties could gain great strength. Even in the countries such as Turkey where Muslim parties are in power, these groups will press for the modernization of their societies and work to temper the move towards political and economic Islam.

**Four**, the large Muslim diasporas numbering some 20 to 50 million in Europe and North America, may seek a refuge in Islam as they come under pressure from the governments of the countries in which they live. This is happening in the United States and has begun to take place in France. The Islamization of the diasporas will create pressures in the countries from which their members come. This includes Pakistan.

**Five**, coming to Pakistan, I believe that the Islamic resurgence since the beginning of the Zia period, the fallout from the war against the Soviet occupation of Afghanistan, and the immediate reaction to America’s war on terrorism will not engulf the political system. It would be checked by the new establishment in Islamabad. Its resolve was demonstrated by the tone and content of the speech delivered on January 17, 2002, by President Musharraf to the joint setting of the parliament.

**Six**, the evolving rapprochement with India will further strengthen the secular forces in Pakistan. And if this rapprochement leads to the establishment of the South Asian Free Trade Area, it will slow down the further move towards a radical transformation of the political and economic systems.

In other words, I don't expect the development of domestic market forces that will create a strong and growing demand for Islamic banking and financial products to happen any time soon. But what about the sources of pressure that have previously propelled efforts to Islamize the economy in Pakistan? These pressures came from Saudi Arabia, the Islamic Development Bank and the Pakistani diasporas. These pressures will continue to yield some results, produce some forward movement, but not bring about a radical change.

In response to these external developments, Pakistan is likely to move towards a system of parallel structures with Islamic institutions of finance and banking co-existing with those that follow the principles of open markets not subjected to ideological constraints. This movement has already started. Let me quote again from Governor Ishrat Husain's recent book. "To achieve a smooth, orderly and gradual transition towards an Islamic financial system, a clear road map has been developed, which allows the conventional and the Islamic systems to run parallel to each other, without severe disruption or abrupt dislocation to the present system. The State Bank has created three windows of opportunities for the industry; it has allowed the opening of dedicated Islamic banks; conventional banks have been allowed to open branches dedicated to Islamic banking; and conventional banks can set up a subsidiary to do Islamic banking. Through institutionalized mechanisms capacity will be developed within the industry by learning from the experience of other countries in Islamic banking, such as Malaysia and Brunei."<sup>6</sup>

In sum, the Islamic economic system in Pakistan is still underdeveloped and will remain that way for a long time to come. Steps will continue to be taken to meet the demands of those who are prepared to invest only in Islamic products, but these steps will be small and will not disrupt the larger economy and its institutional base. Private enterprise—if it is domestic-based—will have no problem in working within this framework. External players, mostly investors from the diasporas and some institutions mandated to put their resources only in Islamic instruments, will be served by institutions that will exist in parallel to the mainstream economy.

## NOTES

1. The Islamic Development Bank is an international financial institution established in pursuance of the Declaration of Intent issued by the Conference of Finance Ministers of Muslim Countries held in Jeddah in Dhul Q'adah 1393H, corresponding to December 1973. The Inaugural Meeting of the Board of Governors took place in Rajab 1395H, corresponding to July 1975, and the Bank formally opened on 15 Shawwal 1395H corresponding to October 20, 1975.

2. There is considerable academic interest in the subject of Islam and the development of the Pakistani economic and political systems. Articles and books continue to be written and published both inside and outside the country. For a reasonable bibliography covering this subject see Akbar S. Ahmed, *Religion and Politics in Muslim Society: Order and Conflict in Pakistan* (Cambridge, U.K.: Cambridge University Press, 1983).

3. Gilles Keppel, *Jihad: The Trail of Political Islam* (Cambridge, Mass.: Harvard University Press, 2002), p. 99.

4. Ishrat Husain, *Economic Management in Pakistan, 1999-2002*. (Karachi: Oxford University Press, 2003), p. 97.

5. Mohsin Khan, "The challenges for Islamic banking" in Asuma Siddiqui, ed., *Authority of Islamic Banking* (London: Institute of Islamic Banking and Insurance, 2000), p. 630.

6. Ishrat Husain, *Economic Management in Pakistan, 1999-2002*.

## Poverty and Social Justice: Some Challenges for Islamization in Pakistan

PARVEZ HASAN

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I must start with a disclaimer. I am not a scholar of Islamic economics. Though I am a western-trained general economist, personally and professionally, I have no problem with mixing ethics and economics and making value judgments. I believe strongly that a just, equitable, and growing economy, in which the economic and social backwardness of the Muslim masses could be addressed, was an important part of the dream that led to the creation of Pakistan. Thus, the eradication of poverty and fair distribution of the benefits of growth are important objectives of an Islamic society, and are very relevant for Pakistan's future.

Let me start with a look at the past and the present situation. How have we fared in meeting the social objectives in Pakistan's 57-year history? My estimates show that, despite very disappointing growth during the last decade or so, average growth in per capita GNP in Pakistan over the long period since independence has been around 2 percent per annum. This is about the same long-term growth rate as in India, though Indian per capita GNP, since the early 1990s, has been growing at 2-3 times the rate of that in Pakistan. In Pakistan, the growth in per head

income has grown notwithstanding an almost explosive growth in population that has more than quadrupled since 1947. It is rather remarkable that, despite considerable periods of political instability and poor economic management, average living standards in Pakistan are now nearly three times their level at independence.

But clearly the distribution of growth benefits has not been equitable. Not only has the gap between the rich and the poor widened greatly, but also the number of poor has multiplied greatly. Currently the number of poor in Pakistan is estimated at over 45 million, with the incidence of poverty at around 33 percent. According to my estimates the number of poor in what is now Pakistan did not exceed 18 million at the time of independence.<sup>1</sup> While the incidence of poverty has declined from an estimated level of 55–60 percent half a century ago, the sharp rise in the absolute number of the poor is a root cause of social problems and tensions and may explain the breakdown of law and order and the growth in ethnic and sectarian violence in the country. Even more disturbing, the trend towards poverty reduction that was visible especially during the 1960s and the 1980s tended to be reversed the 1990s.

The extremely disappointing performance in poverty alleviation is the result of multiple policy failures that are related in many ways to the neglect of Islamic principles of equity, balance and moderation. The neglect of social and human development is a root cause of poverty. That Pakistan lags seriously behind other developing countries including South Asian neighbors is well known. What is particularly alarming is that the gaps in public goods delivery have been widening and the delivery of services to the poor is much lower than the higher income groups.

According to the World Bank's estimates, for example, net primary enrollment rates are 37 percent for the poor, compared to 59 percent for the non-poor; the incidence of medical consultation for diarrhea among children is 79 percent for the poor compared to 84 percent for the non-poor; only 15 percent of married women of ages 15 to 49 in the poorest households have ever used contraceptives, compared to 25 percent of those in the richest households; as many as 24 percent of the poor rely on potentially unsafe sources for drinking water, compared to 19 percent of the non-poor; only about 52 percent of the poor live in households connected to electricity, compared to 76 percent of non-poor households. It is the extremely low indicators for the poor that keep the overall human

development indicators in Pakistan at levels lower than even the Lesser Developed Countries.

Generally low levels of social spending and low priority to human resource development by the governing elite, inattention to pro-poor policies, high population growth, excessive focus on urban areas and neglect of rural areas, ineffective use of resources, and excessive centralization have all contributed to the present plight of the poor.

More generally, the pattern of Pakistan's development has favored the rich by bestowing unearned economic rents on businessmen and industrialists. The government's fiscal policies have not played a role in the redistribution of income. The law-and-order and justice systems have especially discriminated against the poor. Pakistan's income distribution data greatly understate the extent of inequality of incomes. But even the reported data show an increase in the ratio of income of the highest 20 percent of households to the lowest 20 percent from 6 to 8 over the 1980s and 1990s; the bottom 20 percent income receivers have little over 6 percent of total national income—i.e., much less than one-third of the average per head. The present unsatisfactory situation should not detract from the considerable and quite successful efforts made in recent years to:

- Restore macroeconomic stability and sharply lower the rate of inflation, which especially hurts the poor.
- Stimulate the rate of economic growth, which is a major determinant of progress towards poverty reduction.
- Correct the incentives for the private sector by a mix of liberal economic policies and privatization so as to reduce the scope of state discretion in bestowing unearned economic rents. The privatization of state-owned commercial banks is a major step in this direction.
- Devolve authority to elected district governments for delivery of public sector services so as to better reflect people's needs and increase accountability of public officials.
- Increase both social and pro-poor spending. The government's recently completed Poverty Reduction Strategy Paper (PRSP) proposes a

steady increase in priority poverty spending from 4.5 percent of GDP in 2001–02 to 6.8 percent of GDP in 2007–08, implying a near doubling of real spending over the five years 2003–08. It is also encouraging that the PRSP adopts a broader definition of priority poverty spending, which now includes expenditures on law-and-order maintenance, access to justice, and rural electrification services critical for the poor.

These initiatives deserve to be supported by proponents of Islamic economy because they can contribute significantly to reducing poverty in Pakistan and making the society more equitable and just in the spirit of Islamic principles.

The creation of a truly Islamic economic system remains a huge challenge in terms of the development of appropriate economic instruments suitable for modern times. But it requires above all, in my opinion, fundamental changes in societal values. Honest dealings, hard work, fair play, stress on merit and eschewing of nepotism and favoritism, and elimination of corruption are challenges not only for Islamic but all civilized societies. But how can economic and social policies help especially in the transition that promises to be long and hard? My belief is that in the search for efficiency and equity, the objectives—*maqasid*—should always be kept firmly in view. Among these *maqasid* the alleviation of poverty and fairer distribution of growth benefits deserve high priority.

How can the policy agenda be strengthened to help the poor? Let me offer some thoughts.

The pursuit of an interest-free economy is a fundamental pillar of an Islamic economic system. But while pursuing this economic ideal we should give special attention to the exploitative nature of present interest rate structures. As I suggested earlier, the state-dominated banking system has been exploited for the benefit of the few who could use influence to obtain credit. A market-based system will represent progress. Fortunately, the success of macroeconomic policies has also brought a sharp reduction in both nominal and real interest rates. But there are two areas where interest rates are especially excessive. One is the informal sector, where usury rates of interest often prevail and seriously hurt the poor. Better regulation of the informal sector credit and further extension of microcredit schemes through both the public and NGO sectors is needed.

The rate of interest at which government borrows is another problem area. The first part of the problem is that government borrowing has been excessive in the past. For a long period after the mid-1980s and until very recently, the government was borrowing to finance current expenditures. Elimination of this practice in a few years is now part of the Draft Fiscal Sustainability Law. The other problem has been the heavy reliance, again until relatively recently, on the so-called National Saving Schemes at administratively fixed rates. These schemes started as small saving schemes to help low income groups. They became a vehicle for the well-to-do to lend at high real interest rates to a government that was desperate for funds. The rate for ten-year defense bonds peaked at 18 percent per annum in 1997. The rate since then has been progressively reduced to 10 percent but is still high in real terms because inflation is currently around 4 percent per annum. But all those who bought ten-year bonds in the mid 1990s and are holding them are enjoying tax-free annual returns of over 20 percent. The government has made major headway in reforming the system but faces great resistance from the public. In the name of helping pensioners, widows and orphans, special rates above the market are the norm. The public pressure is real. When I was the chairperson of the Debt Committee, I faced a lot of questions from very senior civil and military officers about our recommendation to lower interest rates on NSS instruments. The public needs to be educated on the facts. Certainly, a large number of pensioners, from the government and the private sector, widows, and people belonging to low-income groups depend on profits from these schemes. The bulk of the funds invested in NSS instruments, however, come from a relatively smaller group with a relatively large average holding of NSS instruments. By providing a subsidy through the NSS instruments, the government is diverting scarce public funds from high-priority programs with a much more substantial development impact, such as poverty reduction programs, basic health or education services, or improved infrastructure, and favoring the well-to-do.

Strong efforts to curb corruption will not only improve the level of morality in the society but will also help reduce economic distortions and help alleviate the distress among the poor who are often the worst victims of the use of public power for private gain. Again the attack has to be broadly based. Increasing accountability and moving decision-making closer to the people are important first steps and, therefore, making the



devolution work is critically important. At the same time reducing the discretion of public officials and empowerment of NGOs can help. But the subject of adequate pay for low-level public officials who wield a lot of power but have very low salaries has to be addressed. This is especially true of police, revenue and irrigation departments.

In talking about rural poverty, indeed in enforcing the rule of law in rural areas, the issue of land reform cannot be avoided. I understand Islam permits absentee landlords but does not encourage holding of unutilized agricultural land. Fairness of agricultural rents and fair tenancy agreements are also issues that pose a challenge for Islamic scholars.

*Zakat* and social safety nets such as the Food Support program have been strengthened in the last two years. Still *zakat* collections are at Rs. 5-6 billion, only 0.17 percent of GDP. Even though *zakat* collections are being supplemented with government grants for rehabilitation, the total spending on *zakat* does not exceed Rs. 10 billion. The Food Support program, which extends support to 1.2 million of the poorest households with income of less than Rs. 2000, is now given an annual allocation of Rs. 3.5 billion. But even assuming that all the benefits provided through *zakat* and the Food Support program reach the lowest income households, that is, there is no leakage and administrative costs are minimal—rather strong assumptions—the present level of grants would add only 5-6 percent to the income of the very poor. There is strong case for strengthening these transfers.

In the more dynamic context, special efforts are needed to increase the access of the poor to social services, especially education and health, which I noted earlier is much below average. In education, incentive schemes including scholarships can be used to promote enrollment in both government and private schools. Voucher schemes, which directly support the students, can help create demand for schooling by meeting some of the direct and indirect costs of attending school. They can introduce school choice and competition between schools (reducing unit costs and improving quality), and can be targeted to subpopulations that are underserved or excluded (such as the poor or girls). Other demand-side enrollment incentives have been widely used around the world and take many forms—free textbooks, uniforms, transport, scholarships and in-kind payments to families. (Bangladesh has a very successful female secondary school scholarship program.) Pakistan has some experience with these schemes but generally lags behind.

More generally also, fiscal policy must be used as an instrument of redistribution of income in favor of the poor. It is widely realized that effective taxation on the rich is very light; mainly because of weaknesses in the tax administration machinery. Income tax collections from individuals are not much more than 1.5 percent of GDP. The present efforts to strengthen the Board of Revenue need to be redoubled. The incidence of indirect taxation remains a matter of debate, with lower income groups feeling that this taxation is regressive. At a minimum, a more careful study is required. Overall, there is little doubt that Pakistan's taxation system and expenditure policies are not equitable and compound the problems of injustice in the society.

Finally—and this may be a controversial note—the high rate of population growth, much higher than in either India or Bangladesh, is a burden on the economy, social services, and especially the poor, who have the largest number of dependents. I am encouraged by examples set by large Muslim countries, such as Iran, Egypt, Indonesia and Bangladesh that have supported population control programs. Is there any contradiction between Islamization and population control in Pakistan?

To sum up, in the transition to a fully Islamic economic system, a lot can be done to make Pakistani society and the country's economy more just and equitable. While we pursue an interest-free financial system, we should devote equal attention to other aspects of economic and social policy that lead perhaps to even greater exploitation of the poor.

## NOTES

1. This estimate assumes that the incidence of poverty did not exceed 60 percent in 1947. No formal data for Pakistan are available but estimates for India place poverty incidence at 55 percent (*Economist*, August 16–22, 1997). Earliest data for Pakistan are for the early 1960s and indicate a poverty incidence around 50 percent. It appears highly unlikely that poverty in Pakistan was reduced in the 1950s because per capita growth was negligible and agricultural growth was poor. Therefore, it can be safely assumed that the poverty incidence in 1947 did not exceed 60 percent.

## **The Profit Motive in Islam: Religion and Economics in the Muslim World**

**OMAR NOMAN**

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### **INTEREST AND HAZRAT KHATIJA**

The rich intellectual ferment on the relationship between religion and economics is a reflection of stirring facts at the birth of Islam. In the annals of history, it is difficult to find as progressive a symbol of female independence as Hazrat Khatija, the wife of the Prophet Mohammad.

Hazrat Khatija was a property owner, a major trader who hired men to work for her. One of the men she hired—to take a caravan of goods to Syria—was to become her future husband and the Prophet of Islam. Thus market principles, private property, commerce and trade were part of the economy into which Islam was born. It should be noted that interest was not prohibited in the transactions that defined this economy.

These origins have long been ignored in the subsequent ideological battles that have afflicted the Muslim world. The theological bent towards one or another position has been part of a wider debate between social reformers from the left or the right.

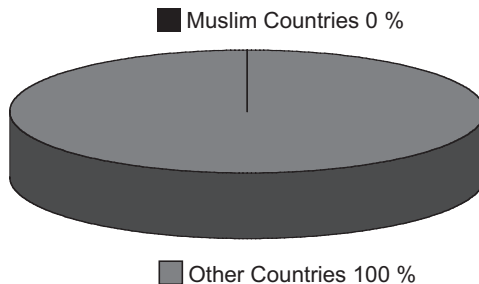
Social reformers of the left have sought inspiration from the social equity aspects of Islamic welfare tradition to make a case for a socialist oriented economy. “Islamic Socialism,” particularly popular in the 1970s, typically justified the takeover of private property. Islamic socialism was used to sanction nationalization or land reform. The broad equity principles of Islam were invoked against excessive concentration of private property as the source of inequity.

Discomfort with this position—and the obvious contradictions with a religion so firmly intertwined with the principles of a market economy—were examined by Marxists analysts. Maxime Rodinson’s *Islam and Capitalism* provided a strongly argued case for the consistency between capitalism and Islam, marshalling a range of historical facts to make the case that there is no fundamental contradiction between the two. For analysts of the left, such as Rodinson, Islam was subject to both interpretations—by those who would invoke its origins for a capitalist economy, and by those who had to interpret its progressive spirit for a socialist economy. The outcome in any country or region would be a result of a struggle over ideas and their interpretation.

For social reformers from the right, who acquired prominence in the Muslim world after the oil price shock in the mid-1970s, Islamic principles implied a different view of the economy. Far from justifying socialism and state confiscation of private property, these reformers were concerned with certain practices, which defined the *Islamic* nature of the economy.

Their definition of a third way between capitalism and socialism envisaged a loose confederation between capitalism and Islam. It consisted of a

**Figure 1: Percentage of Muslim Countries as Share of Top 25 (HDI Rank)**



private sector-based economy circumscribed by Islamic injunctions. The most prominent amongst the latter were prohibitions such as *riba* (interest), and obligations such as *zakat* (a form of wealth tax). The agenda defined by the social reformers of the right has subsequently revolved largely around the role of interest in a capitalist economy.

There is little contention over *zakat* since it is viewed as another tax, which is part of the redistributive role of the state in modern societies—except that *zakat* has a rate prescribed by tradition and an emotive value associated with tradition. In no country has *zakat* become a source of intense debate or the cause for institutional reform.

This is not the case with interest. Much of the traction on Islam and the economy has been defined, by the right, in terms of the role of interest and thereby of the financial sector in a modern economy. Amongst other Muslim countries, Pakistan is grappling with this legacy, an issue we turn to later.

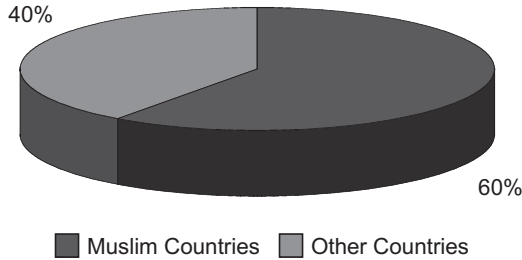
It is worth noting that the issue of interest—real or nominal, compound or simple—has bedeviled religions other than Islam. Justinian (527–565), for example, had forbidden compound interest a century before the birth of the Prophet of Islam. In the modern, world however, debate over the sanctity of interest is confined to social reformers of the Muslim right. In a number of countries, they have exerted pressure on technocratic managers of the economy and on bankers steeped in a very different view of the role of interest in a modern economy. Accommodating these political pressures, while ensuring that the economy is not adversely affected, is a delicate balancing act.

Before delving more deeply into the debate, and making suggestions, it is worth providing an overview of the current state of human development in the Muslim world. This will provide the context for the testing of tolerance towards religious injunctions while adhering to the requirements of modern economic management.

## **CURRENT STATE OF HUMAN DEVELOPMENT OF THE MUSLIM WORLD**

None of the countries in the top 25 in the global Human Development Index rankings is Muslim (Figure 1). The bottom 25 is almost equally divided amongst Muslim and Christian countries; 60 percent of the bot-

**Figure 2: Percentage of Muslim Countries in Bottom 25 in HDI rank**



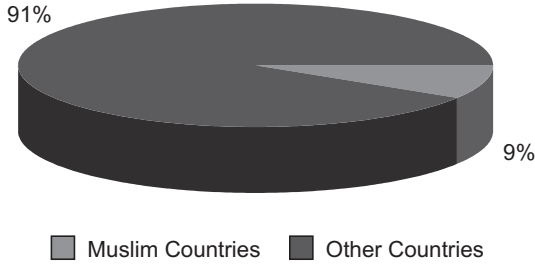
tom 25 are Muslim (Figure 2). Just 9 percent of the countries in the high human development category are Muslim (Figure 3).

Related to these levels are a couple of striking features of the Muslim world in general. The first is the low level of female enrollment. For low HD countries, the average female primary enrollment rate is 43 percent compared to 54 percent for non-Muslim countries. (Figure 4). The relatively poor social performance is also reflected in Figure 5, which compares the ranks of countries in terms of per capita income and human development index. A positive score implies that a country is doing well in education and health in relation to its income. A negative score implies the reverse—i.e., that human development is lagging behind income. The vast majority of Muslim countries (33) have a negative rank, while only 13 have a positive rank (Figure 5).

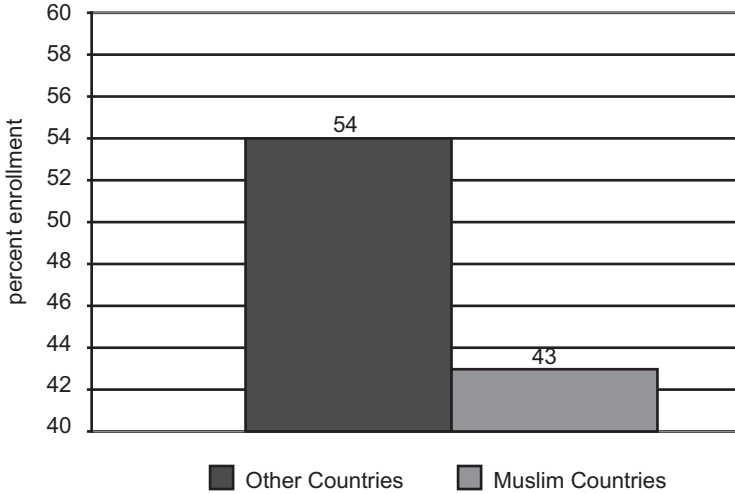
While the news from the high and low rankings of HD is not comforting, analysis of the medium HD countries is more promising. Thirty-one percent of the medium HD countries are Muslim (Figure 6). In this category the difference between female enrollment rates (Figure 7) is negligible; Muslim countries have an average rate of 84 percent while non-Muslim countries have more or less the same level of female enrollment (85 percent). In the high HD category, however, the Muslim female enrollment is 86 percent, which is 12 percent below others (Figure 8).

As far as GDP per capita ranking is concerned, 12 percent of the top 25 countries are Muslim (Figure 9), while the Muslim share constitutes a majority—56 percent—of the bottom 25 (Figure 10).

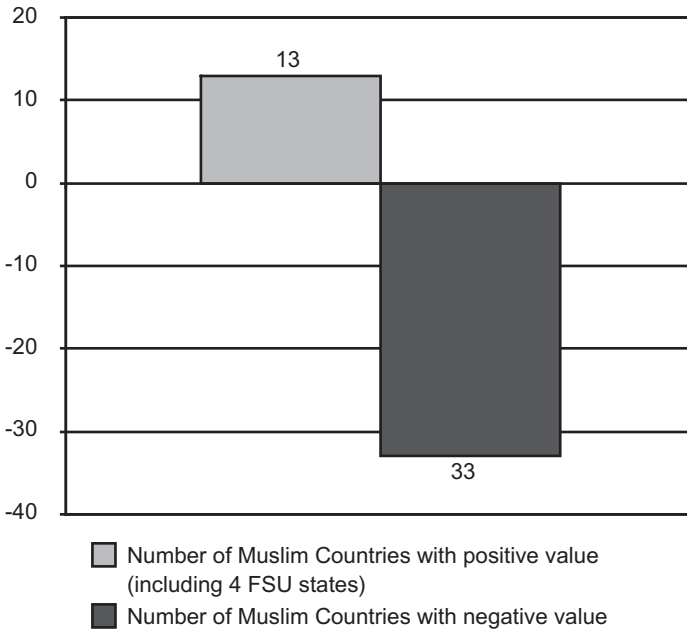
**Figure 3: Percentage of Muslim Countries as Share of High Human Development Countries**



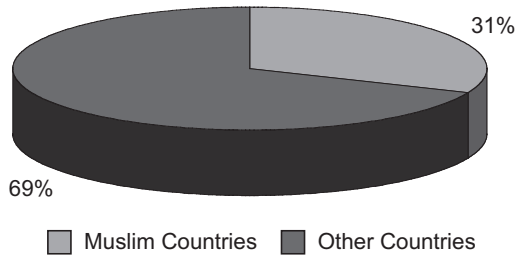
**Figure 4: Average Female Primary Enrollment (%) among Low Human Development Countries**



**Figure 5: Number of Muslim Countries in Terms of GDP Rank Minus HDI Rank**

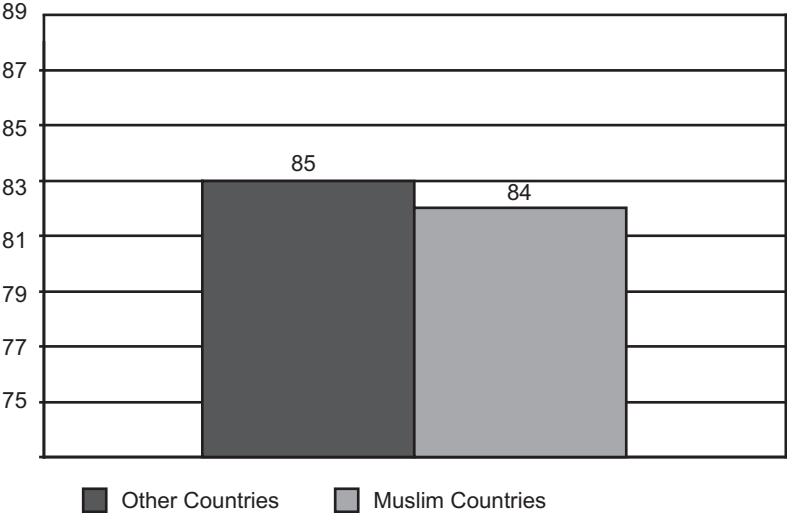


**Figure 6: Percentage of Muslim Countries as Share of Medium Human Development Countries**

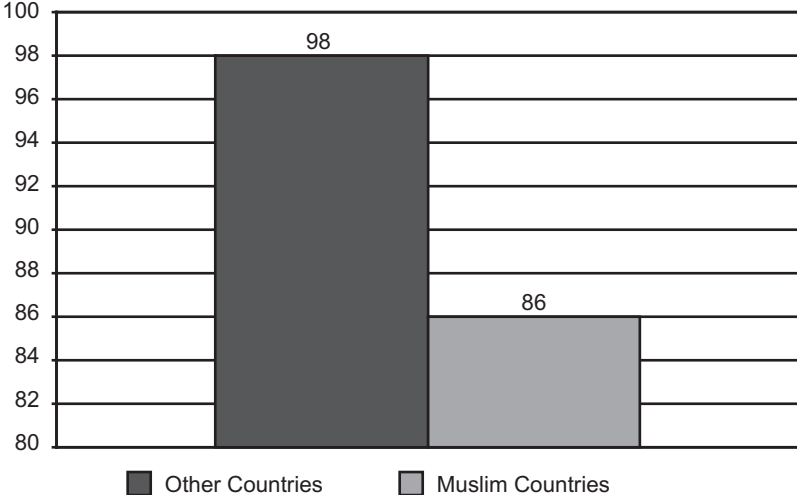




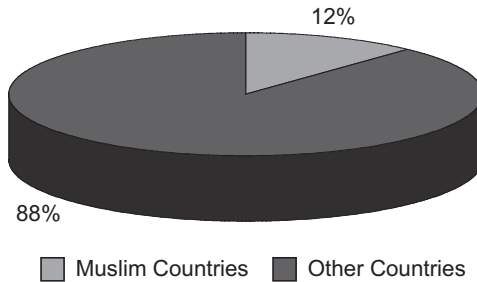
**Figure 7: Average Female Primary Enrollment (%) among Medium Human Development**



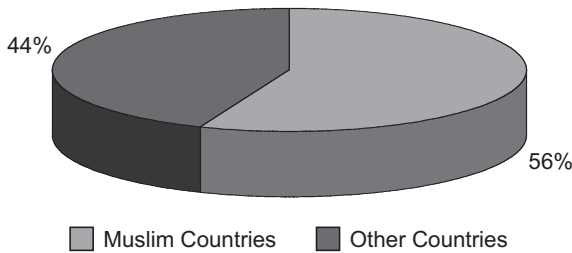
**Figure 8: Average Female Primary Enrollement (%) among High Human Development Countries**



*Figure 9: Percentage of Muslim Countries in Top 25 in Terms of GDP per capita (n PPP terms)*



*Figure 10: Percentage of Muslim Countries in Bottom 25 in Terms of GDP per capita (in PPP terms)*



In sum, two aspects of the Muslim universe are evident from this cursory overview—the need to raise average incomes to catch up with the rest of the world, and the need for investment in education and health, particularly of women. These are the real, urgent development challenges facing the Muslim world, and the context within which we should judge the significance placed on issues such as interest-free economy.

### **AN INTEREST-FREE ECONOMY OR INTEREST-FREE FINANCIAL INSTRUMENTS?**

Would an interest-free economy help raise the level of incomes and improve the standard of living of people living in Muslim-majority coun-

tries? Would better education, health or higher income ensue from interest-free banking, or is that desire purely related to ideological considerations rather than economic outcomes?

The debate on whether Islamic injunctions were against interest *per se* or usury is protracted and frequently emotional. One school holds that in any market economy, capital has to have a price and the price of that capital is called interest. Economies in which Muslims have lived have always charged interest. Further, there is the issue of inflation. In any economy with inflation, or deflation for that matter, a distinction between nominal and real interest is important. In an inflationary economy, not charging even nominal interest would remove any incentive to lend. Lenders will lose the value of their money just through the act of lending; borrowers will gain by simply returning the same amount of money—which of course will buy less in an inflationary economy. Thus interest has to be charged just to retain the value of the money lent. Any positive real rate of interest is the price for use of that capital.

Thus for one school of economists, Islam has never prohibited such interest—indeed Muslims throughout history have charged both nominal and real interest. Within this view, Quranic injunctions against *riba* really refer to usury—the practice of charging extremely high interest, particularly to those without collateral. Since those without collateral are, by definition, likely to be the poor, this implies higher interest for those who can afford it least. It is these usurious interest rates that the Quran is opposed to, rather than interest charged through formal financial institutions.

The more intransigent position in the debate is firmly rooted to fundamentals. An absolutist claim is made with regard to banning all forms of interest. This interpretation is based on a distinct view of the burden of risk in society. Those who engage in business should acquire an equity stake in the enterprise. They would thus share in the risk burden, rather than profit from lending to the enterprise, irrespective of its fortunes. While bankruptcies provide a discipline against irresponsible lending in modern economies, these are not viewed as institutional mechanisms for an Islamic economic system.

This diversity of debate in the Muslim world is worth noting. There is no distinct, single view held on interest. There is a wide gulf between conservatives and liberals. But the agenda on interest-free economy is driven very firmly by the conservatives.

Indeed it is worth noting that “Islamic economics” is of modern 20th century origin. Even at the turn of the 19th century, the phrase was not used by major Islamic thinkers. The great philosopher Iqbal, who was inspirational to the movement for Pakistan, did not refer to religion in his treatise on economics. Iqbal’s *Ilm-ul-Iqtesaad*, published in 1902, was notable in its absence of religion in the understanding of the economy. The intellectual father of Islamic economics is Maulana Maudoodi, the scholar whose views have shaped the Jamaat-e-Islami. Much of the credit for articulating Islamic economics goes to Maudoodi. The Jamaat is a cadre-based political party operating across much of South Asia, but especially strong in Pakistan and Bangladesh. The zenith of its political influence has thus far been during the tenure of General Zia of Pakistan.

The Jamaat provided intellectual leadership to many of the Islamization measures, and also became a vital ally in the *jihad* against the Soviet Union in Afghanistan. In this endeavor it received strong support from Saudi Arabia and the United States, for differing geopolitical and ideological aims.

### **THE POLICY CHOICE: VOLUNTARY INSTRUMENTS VERSUS MANDATORY SYSTEMIC CHANGE**

The economic managers and civil servants of most Muslim countries continue to operate in a framework where policy instruments are geared to improve growth, efficiency or equity. The combination of priority objective is determined by the political leadership. One of the larger challenges on the policy front has been the current phase of globalization. Economic managers have to engage in an extensive series of tariff, foreign exchange, fiscal, monetary and other reforms to retain competitiveness and respond to the changing global environment.

In the midst of this policy environment, some countries have chosen to undertake comprehensive and radical ideological change to their economies. Just two countries, however, have eliminated interest on theological grounds—Iran and Sudan. The record of both economies is rather dismal, for a variety of reasons. Enmeshed in conflicts, facing periodic sanctions, slow to undertake much needed macroeconomic reform, these economies have extremely poor records. An interest-free financial system has certainly had no apparent effect in improving the functioning

*Table 1: Nominal Returns on Savings Deposits at Turkish Banks*

Months	Term					
	3 Months		6 Months		1 Year	
	Conventional Banks	Islamic Banks	Conventional Banks	Islamic Banks	Conventional Banks	Islamic Banks
<b>June 1990</b>	11.64	11.68	25.38	24.90	69.47	69.42
<b>January 1991</b>	12.34	12.02	25.51	24.61	56.25	57.12
<b>June 1991</b>	15.25	15.20	26.92	26.60	58.79	58.83
<b>January 1992</b>	15.68	15.58	30.51	30.46	65.11	64.30
<b>June 1992</b>	15.91	16.01	30.00	30.39	66.84	66.16
<b>January 1993</b>	14.72	15.65	29.88	30.43	66.96	64.51

Notes: Figures represent weighted averages of the returns to depositors over the designated periods for all banks within the category.

Source: *Köfçoğlu* (1994, p.28)

of either economy. Such mandatory systemic change remains rare in the Muslim world.

The more common example is voluntary instruments. These non-interest-bearing financial instruments operate alongside others. Thus countries such as Malaysia and a host of Middle Eastern states provide the option for investors to put their savings into equity-oriented non-interest instruments.

In principle these instruments are no different from ethical bonds or environment-oriented bonds. Individual or institutional savings are being channeled into financial instruments which provide returns, subject to some values embodied in the management of the fund.

It is perhaps not surprising that some of the most enthusiastic support for interest-free financial instruments has come from “Western” banks. Virtually all of the major retail banks operating in the Muslim world offer savers the opportunity to put their resources into equity-based instruments. An estimated 200 institutions in 60 countries offer an interest-free alternative to conventional banking. An estimated \$150 billion worldwide is managed by through these instruments.

While these instruments are not supposed to provide interest, the return they provide tends to mirror the interest rate prevalent in the economy. For example, as Table 1 shows, there was very little difference between the returns provided by Islamic banks in Turkey, as compared to the conventional banks operating in the country.

## **THE CASE OF PAKISTAN**

The evolution of Islamic banking in Pakistan is reflective of global developments across the Muslim world. Immediately after independence, the secular ethos of the civil service and the military surfed over the minor wave of demands for Islamic instruments. The 1956 constitution ignored religious injunctions and through the course of the 1950s and 1960s, economic policy making was entirely oblivious to religious debates which were viewed as obscurantist and ill-informed.

During the period of Islamic socialism of the early 1970s, religion was utilized creatively to justify measures ostensibly taken to increase equity. The nationalization of industrial and banking assets during 1972-74 was accompanied by rhetorical flourishes related to the equity principles of

Islam. Similar injunctions were invoked for land reform. Yet, by and large, under Z.A. Bhutto, the regime was concerned with matters other than religion. Toward the end of his period in office, Bhutto responded to pressures for religious reform, rather than enthusiastically leading change towards a more religious slant in public policy.

Those familiar with Pakistan's evolution are familiar with the radical change brought by General Zia ul-Haq. A large spectrum of constitutional and other legal changes altered the structure of the Pakistani state. New theocratic institutions, such as the Federal Shariat Court, acquired prominence over laws. New laws, such as the Hudood Ordinance, defined public morality.

A component of the theocratically sanctioned changes related to the financial sector. A Shariat Court judgment decreed that the whole economic system must be based on interest-free instruments. Subsequently, various regimes have stalled full application of this order. Various ways of delaying implementation and modifying the injunctions have been found. Legal battles over interpretation have been fought and subtle ways found to avoid a clash over the order to convert to an "Islamic economy."

The future course is an obvious one. Faced with a choice of adopting a comprehensive mandatory Islamic system—as in Sudan, or allowing flexible interest-free instruments, as in Malaysia—the government of Pakistan will choose the latter. The alternative—adopting a theologically based economy—makes no political or economic sense. At a time when Pakistan is keen to project an image of a liberal Muslim state, the ghosts of Zia's legacy have to be buried firmly. They represent a theocracy and a dangerous, repressive view of Islam. This is not a version that President Musharraf or his economic team cherishes. Allowing choice but forbidding mandatory change is the only option, and the course that the government of Pakistan is bent on taking.

It is not much of a choice. The proponents for Islamic economics have not made any rigorous case of how adopting their recommendations would accelerate growth, reduce poverty, or improve the status of women. The arguments tend to be purely on grounds of piety, not socio-economic performance. Undertaking mandatory radical change in the financial system, for no improvements in efficiency or equity, is an odd demand to take seriously.

## THE WIDER MUSLIM CONTEXT

Pakistan's decision is being made in the wider context of ideological struggles within the Muslim world. There are those who wish that Muslim countries would withdraw into an insular cocoon and try to catch up with the modern world by reviving past glories. The economic component of this theocratic vision is an Islamic economic system. Amongst this group are men like Qutb, the Egyptian intellectual mentor of Osama bin Laden, who noted that "There is nothing that Islam tries to copy...neither does it establish any connection with civilizations which are separate." Other fellow-travelers include the Shia cleric of Iraq, Al-Sadr, whose *Iqtisaduna* was devoted to debunking Arab socialism and establishing the need for an Islamic economic system.

Firmly opposed to the theocrats are the vast majority of Muslim nations trying to come to terms with the challenges of globalization and modernity. The choice between a mandatory interest-free economy and a financial system which allows discretion in the use of interest-free instruments has to be viewed in this wider context.

Hazrat Khatija is a potent reminder of another important aspect of tradition—property-owning, independent, educated women. Some traditions can haunt conservative social reformers.

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## Gender Disparities, Economic Growth and Islamization in Pakistan

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Pakistan's economy has not sustained the growth rates required to reduce the country's dire poverty. Today, nearly 40 percent of the population lives below the poverty line, an increase from a decade ago. Several factors contributing to Pakistan's disappointing economic performance are well known: excessive defense spending at the expense of human capital development, weak governance, corruption, instability, sectarian violence and the draining Kashmir conflict. Another factor which has received less attention is Pakistan's persistent, and in some cases growing, gender disparities. The critical link between the status of women in society, particularly literacy levels, and a nation's economic growth is now well understood. The low socio-economic status of women in Pakistan is beginning to be recognized as a potentially significant drag on the country's growth.<sup>1</sup>

What impact has Islamization—meaning, broadly, the economic, political and social policies designed to promote an Islamic state—had on the role of women in Pakistan? Gender roles in developing economies are largely determined by strongly held cultural norms and traditions. In

Pakistan, this reality is reflected in the significant regional gender differences that exist across the country.<sup>2</sup> However, within Pakistan, the impact of Islamization on women is a topic of debate and political friction. Many Islamists claim that their policies are women-friendly and egalitarian. Leaders of the Islamist coalition Muttahida Majlis-e-Amal (MMA) note active female participation in the party, their emphasis on social welfare, and their pledge to “protect the rights of women guaranteed by Islam and the restoration of their honor and prestige.”<sup>3</sup> Many critics of Islamization disagree. They claim that Islamization restricts opportunities in the public sphere for women, and thus has had a negative impact. Pakistani journalist Jugnu Mohsin sums up this perspective: “‘Islamisation’ has its own logic. It appropriates more and more space and leaves no room for societies to grow organically and in synch with the rest of the world. Secular culture is a victim and women bear the brunt of this.”<sup>4</sup>

Gender roles in Pakistan today reflect the weight of culture and tradition, but Islam is an important and influential overlay. In general, Islamization tends to reinforce conservative ideas regarding the role that women should play in society. At a minimum, this slows down policies and programs designed to bring women more into the public sphere, and thereby exacts an economic cost. This paper focuses narrowly on the potential economic consequences of Islamization’s impact on women.

## **GENDER DISPARITIES A DRAG ON ECONOMIC GROWTH**

Despite numerous commitments to gender equality during past decades, Pakistan has made insufficient progress on a range of important gender measurements. The country’s skewed sex ratio of 108 men to 100 women is a reflection, in part, of higher female infant mortality and the overall more privileged treatment of boys. Given female biological advantage at birth, male mortality rates are expected to be higher than female rates. The sex ratio in a country is thus a first indication of gender discrimination.<sup>5</sup> Two areas of gender disparity in particular warrant examination because of their linkage to economic growth: female literacy and workforce participation.

Pakistan has for decades grossly underinvested in education, and in particular, girls’ education. Education spending is mired at roughly 1 percent of GDP, and in this environment of resource constraints, girls tend to be

short-changed. Overall literacy is only 44 percent while adult female literacy is less than 30 percent. Moreover, the gap between male and female literacy rates has widened. In 1975, the literacy gap between men and women in Pakistan was 25 points (11 percent literacy for women vs. 36 percent literacy for men). By 2001, that gap had inched upward to 29 points (29 percent literacy for women versus 58 percent for men).<sup>6</sup> Every one of Pakistan's governments has launched an educational initiative, most with the clear objective of closing gender gaps, and every one has failed to make notable progress. The number of illiterate Pakistanis has doubled since 1951, while the number of illiterate women has tripled, due to population increases.<sup>7</sup> In fact, Pakistan's high fertility rates are now understood to be strongly correlated with its low level of female literacy.<sup>8</sup>

Given the connection between female literacy and economic development, educating girls in Pakistan should be a national obsession. Successful poverty reduction depends on myriad complex, interrelated factors, and there is clearly no silver bullet. However, a compelling body of evidence has emerged in recent years demonstrating that investing in girls' education is the most effective way to pursue a broad range of critical development objectives. Educated women have fewer children, provide better nutrition and health for their families, experience significantly lower child mortality, generate more income and are far more likely to educate their children than women with little or no schooling, creating a virtuous cycle for the community and the country. Several studies have shown that female education can also contribute significantly to agricultural productivity.<sup>9</sup> Given that agriculture comprises roughly a quarter of Pakistan's GDP, this is an area that deserves more attention. Mounting empirical data now indicate that the returns to educating girls are greater than the returns from educating boys.<sup>10</sup> The bigger the gender gap in primary education, the higher the return of investing in girls' literacy.

Islamization is clearly not the reason for Pakistan's low female literacy rates. Most Islamists are careful to stress their support for female education. However their emphasis on a traditional role for women and the need to protect women's honor reinforces cultural norms that limit female mobility and access to the public sphere. This compounds the already large challenges of getting and keeping girls in school. It also limits the economic returns from girls' education, reducing incentives for parents to invest in their daughters' education.

Pakistan also has a very low level of female workforce participation. The economic benefits of female employment are clear: more women working increases a nation's output and is an important contributor to household income. Moreover, recent studies indicate that women's and men's relative control of resources has significant and different impacts on household consumption patterns. When women control resources, more of those resources are devoted to family welfare—especially nutrition, education and health—than when men control the resources. Less is devoted to alcohol and cigarettes.<sup>11</sup> At the margin, female control of resources results in a greater positive impact on child survival, nutrition, and school enrollments than does male control of resources. Simply, women tend to invest more in the human capital of their children than do men. The impact on long-term development is obvious.

Today, Pakistan's female formal labor force participation rate hovers around 15 percent.<sup>12</sup> While that represents a tripling over the past 20 years, female labor force participation is still low in an absolute sense and relative to other countries with similar per capita GDP. In Bangladesh, for example, female labor force participation is 57 percent.<sup>13</sup> Increasing women in the workforce is both a challenge and an opportunity for Pakistan. Clearly, Pakistan's low rate of female literacy is an obstacle to workforce participation. But as education levels rise, labor force participation must also rise for Pakistan to capture fully its return on investment in girls' education. Creating employment for women in a country with high unemployment rates, in some areas as high as 40 percent, is an obstacle. Policymakers express concern that increasing female workforce participation would raise unemployment levels. However, microeconomic data show those fears to be unfounded. In fact, data indicate that an economy that is more inclusive of women in the labor force is also likely to enjoy lower unemployment.<sup>14</sup> Foreign direct investment in export-oriented sectors such as textiles is also positively correlated with rises in female labor force participation. While economists are unclear whether this is cause or effect, Pakistan has largely missed out on foreign investment in light manufacturing and service industries that today employ large numbers of women from Mexico to Bangladesh. These jobs represent a ticket to the middle class for the female employees and their families.

For Pakistan to significantly improve its female labor force participation rates, it will have to address a range of structural barriers and social con-

straints, many of which are reinforced by Islamization. With its emphasis on women as keepers of the family honor, promotion of gender segregation and institutionalization of gender disparities, Islamization has not encouraged formal employment for women in Pakistan. Religious extremism, as perceived by multinational corporations (defacing posters of women make international headlines), also makes Pakistan a less attractive destination for foreign direct investment. Pakistan's government is beginning to support microfinance initiatives in a serious fashion, which helps the poor, particularly women, start their own businesses. The government, with a \$150 million loan from the ADB, established the Kushali Bank in 2000. In 2002, Kushali lent \$15 million to 65,000 customers, one-third of whom are women. Other organizations like the Kashf Foundation are focused exclusively on women. Kashf is scaling up quickly and is on target to have 100,000 clients by the end of 2004. To date, Islamization has not impeded the spread of microfinance, but elimination of interest rates in banking, as proposed by some Islamists, would seriously impact the whole financial sector.<sup>15</sup>

### **ISLAMIZATION'S IMPACT ON WOMEN**

Pakistan clearly has significant gender disparities, and economists are beginning to document the constraints these impose on economic growth. What is less clear is the impact of Islamization. To what extent have Islamization policies contributed to Pakistan's gender disparities? As stated up front, gender roles are largely determined by culture, but Islamization plays a role in reinforcing traditional culture. Proponents of Islamization position their policies as being a positive force for women, emphasizing that they serve to protect women's dignity and honor. The main Islamic parties in Pakistan today are careful to put a "women friendly" face on their actions, stressing that they are not interested in a program of "Talibanization." Instead, they focus on the perceived social benefits of maintaining a more traditional role for women in society as being pro-family. Others see things differently. They label policies as reactionary and anti-female. Usually their focus is on the discriminatory legal environment stemming from Shari'a, but other policies catch their ire too, such as gender segregation and the Islamists' hostility towards family planning.

The tension between Shari'a and established human rights standards and women's rights is well documented. In general, this literature focuses

on how the restoration of Shari'a as public law in Muslim countries erodes the status and rights that women have achieved under secular law.<sup>16</sup> Pakistan's constitution guarantees women equal rights, and empowers the government to take affirmative action to protect and promote those rights. However, over the years, parallel Islamic legal systems have been promoted which undermine those rights, like the Federal Shari'a Court (FSC) established by General Zia ul-Haq in 1980. The gender bias of Shari'a is undeniable. Women have unequal rights to inheritance, termination of marriage, minimum age of marriage, and natural guardianship of children. Polygamy is allowed, and there are grossly inadequate provisions for women's financial security after divorce. Pakistan's controversial Hudood Ordinances, particularly with regard to *Zina* (sex), are also discriminatory. By blurring the line between rape and adultery, the Zina Ordinance creates the possibility that a woman can be convicted of adultery if she cannot prove rape.

Today, the MMA is working to strengthen the Federal Shari'a Court through constitutional amendments and by inducting more ulemas to the court. In the Northwest Frontier Province, where the MMA controls the provincial government, it has called for the implementation of the recommendations of the Council for Islamic Ideology (CII) in the province. The MMA have also established a 14 member Nifaz-e-Shariat Council (NSC) to help the provincial government implement Islamic rules and reforms recommended by the CII. On June 2, 2003, the NWFP government passed a bill to implement Shari'a in the province. Most controversially, some are pushing to establish a Taliban-esque Ministry for the Promotion of Virtue and Prevention of Vice, which would carry out its mandate through a special "Hasba force" or vice squad.<sup>17</sup> The added challenge is that once religiously oriented laws are on the books, it is very difficult to remove or change them.

Women's groups have campaigned strenuously against Islamization in general and specifically for repeal of the Hudood Ordinances because of their gender discrimination. Benazir Bhutto made the "anti-female" bias of General Zia ul-Haq's Islamization policies a major theme of the 1988 national campaign.<sup>18</sup> More recently, the National Commission on the Status of Women (NCSW) urged the government to repeal the Hudood laws in a much-publicized report in August 2003. The Commission noted that the Zina Ordinance in particular had been relentlessly used against

women, particularly poor, illiterate rural women. Its final report asserted that as many as 88 percent of women in Pakistan's jails are there because of ambiguities in the Zina Ordinance.<sup>19</sup> However, others believe these claims to be overstated.<sup>20</sup> The MMA has rejected outright the findings of the NCSW regarding the Hudood laws. The Musharraf government has also distanced itself from the report in the wake of the MMA's support in late 2003 for the Legal Framework Order—a package of constitutional amendments legitimizing the military's political control.

The discriminatory nature of Islamic legal reforms for women in Pakistan is clear, but the extent of their impact is hard to measure. Human rights activists are correct to focus on specific cases of discrimination, even if the number of actual cases is relatively small. But it is misleading to conclude that the overall impact is marginal. Indeed, Islamic legal reforms and the Hudood laws in particular have served to reinforce male social control over women, limiting female bargaining power within the family and their control of resources. This has also contributed to an environment where violence against women is not sufficiently discouraged.<sup>21</sup> The economic costs can be found in suboptimal resource allocation and lost female productivity.

Gender segregation is another area that makes modernists, secularists and women's groups anxious about Islamization. It is easy to dismiss some of the Islamists' recent actions toward women as frivolous: indeed, banning female mannequins and faces of women in advertisements might be high on rhetoric and low on impact. Enforcing restrictive dress codes and segregating higher education create more concerns, precisely because these policies reinforce traditional, conservative roles for women, particularly in rural settings where 70 percent of the population lives. As activist Bushra Gohar notes, "The women in (NWFP) are already backward because of the conservative social set-up. The MMA want to push women further back."<sup>22</sup> Moderates worry that these steps will lead to broader segregation, in public spaces and the workplace. It is important to note that these actions are not just confined to the MMA stronghold in NWFP, which comprises only 13 percent of Pakistan's population. Groups associated with Jamaat-i-Islami have disfigured billboards depicting women in the Punjab too, and in Karachi, the local Jamaat-run council has banned the depiction of women in advertisements as "obscene and vulgar."<sup>23</sup>

The MMA has said that it is committed to achieving full literacy across society within 10 years, but it has also promised to ban co-education and create separate educational institutions for women.<sup>24</sup> Unfortunately, the two policies may collide, since the additional costs imposed by segregation will again likely be at the expense of female education. The widening gap between male and female literacy rates has already been noted. Women in Pakistan also have fewer higher educational opportunities. In 1997, out of 172 professional colleges, only 10 existed for women. Women can gain admission to others only against a reserved quota.<sup>25</sup> In 2000–2001, only 27 percent of enrollment in Pakistan’s professional colleges and universities was female.<sup>26</sup> The MMA commitment to build more women-only colleges worries many as a step toward a Saudi-inspired goal of complete segregation between men and women: first schools and health care facilities, then public spaces and the workplace.

Segregation in the health arena has already been pushed in NWFP. Last year, the MMA in the NWFP legislated that female patients could only be seen by a female doctor, and that men are not allowed in female hospitals. If broadly enforced, this could prove detrimental to women’s health in that province, given the lack of trained female healthcare professionals, particularly in rural areas. Pakistan’s high maternal mortality rates—one in 38 women dies from pregnancy-related causes—already impose a significant cost on society.<sup>27</sup> Only 20 percent of deliveries are attended by a trained professional today.<sup>28</sup>

Pakistan has rightly begun to focus its limited health resources on primary health and basic facilities in rural areas. However, to the extent that Islamization limits women’s ability to access resources, it could have a negative impact on Pakistan’s pressing need to improve community health and slow its population growth rate. A recent study by the Population Council shows how conservative norms already constrain female access to health care in rural Pakistan. Ninety-six percent of females aged 15–24 need permission to travel to a nearby health outlet. The primary reasons given for travel restrictions all relate to family reputation and family tradition.<sup>29</sup>

Another factor that could hinder Pakistan’s economic development is the Islamists’ antipathy to family planning. Providing Pakistan’s female population with access to basic family planning services is critical. Pakistan is the fastest growing large country in the world today. Its current population of 150 million is projected to grow to 350 million by 2050, which



will make it at that point the fourth largest country in the world behind China, India and the United States. Population growth must be slowed if Pakistan is to deliver on raising per capita GDP, yet the Council for Islamic Ideology (CII) recommends that family planning should be withdrawn, as the Council claims that it is un-Islamic and that increasing population is not a burden on the country.<sup>30</sup>

The Islamists' resistance to family planning in general puts them at odds with the government's development agenda. It also creates challenges for many non-governmental organizations (NGOs). In Baluchistan and NWFP, NGOs have come under considerable pressure for their perceived pro-Western agendas. They have been asked to follow stringent screening and registration procedures.<sup>31</sup> NGOs are essential in the area of women's health, where the government has largely neglected its responsibilities. If the MMA follows the recommendations of the CII and adopts a hostile attitude toward family planning services, NGO activities will inevitably be constrained. The World Bank and the Asian Development Bank (ADB) have substantial programs in the NWFP with a heavy emphasis on improving the status of women. Both are monitoring the MMA's direction. Marshuk Ali Shah, the ADB's country director, notes that the ADB has "a major women's reform agenda—the empowerment of women. If [the MMA] takes a stringent view, it will definitely affect our relationship."<sup>32</sup>

## CONCLUSION

Islamization has been tolerated or promoted for political purposes by every government in Pakistan since the nation's founding. The impact on society, particularly on women, is hard to measure. The intent of this paper is not to draw a causal relationship between Islamization and the traditional role of women in Pakistan. Clearly, the status of women in society has been shaped by centuries of culture and tradition. The goal is simply to demonstrate that to the extent that Islamization promotes that traditionalist culture, it comes at an economic cost. Until Pakistan creates a more gender-neutral legal environment, closes its gender gaps in health and education, and reduces barriers to female labor force participation, its economic growth and development will lag. While it is impossible to quantify precisely the economic impact, other studies indicate that clos-

ing significant gender gaps can add as much as 1 percent annually to per capita GNP growth.<sup>33</sup> As Pakistan struggles to reduce poverty in the midst of fast population growth, the question it must contemplate is whether it can afford Islamization's conservative notions of women.

## NOTES

1. Farzana Bari, *Women in Pakistan: Country Briefing Paper* (Manila: Asian Development Bank, 2000).

2. For example, Baluchistan, deeply tribal but not known historically for its religiosity, has perhaps the most restrictive environment for women in Pakistan. The cultural practice of "purdah," the complete veiling of a woman's face and body, is still widely practiced. The sex ratio is 114:100 (men to women) and the rural female literacy rate is less than 10 percent.

3. MMA 15-Point Manifesto reprinted in Ashutosh Misra, "Rise of Religious Parties in Pakistan: Causes and Prospects," *Strategic Analysis* 27, no. 2 (April/June 2003).

4. Jugnu Mohsin, e-mail correspondence with author, December 27, 2003.

5. Elizabeth King and Andrew Mason, *Engendering Development through Gender Equality in Rights, Resources, and Voice* (Oxford: World Bank / Oxford University Press, 2001), p. 47.

6. World Bank EdStats Database, <http://www1.worldbank.org/education/edstats/> (data query system; accessed January 15, 2004).

7. Bari, *Women in Pakistan*.

8. UNDP economist Omar Noman suggests that Pakistan's population would be 30 million fewer than it is today (115 million vs. 145 million) if it had improved female literacy at the same rate as did Southeast, East and Central Asian countries over the past five decades. Omar Noman, *Economy of Conflict*, forthcoming.

9. One World Bank study indicates that in areas where women have very low levels of education, providing all women with at least a year of primary education raises farm yields by as much as 24 percent. Increasing land area and fertilizer usage to male farmers' levels increased women's yields by only 10.5 percent and 1.6 percent respectively. While these

results need to be viewed with caution, they are consistent with other research that shows that increases in female education lead to higher rates of technology adoption for female farmers—more so than increasing land size. The results were derived from simulations assuming constant elasticities and presupposing that changing levels of one input does not change the elasticities of other inputs. Agnes Quisumbing, *Improving Women's Agricultural Productivity as Farmers and Workers*, ESP Discussion Paper Series No. 37 (Washington, DC: World Bank, 1994).

10. T. Paul Schultz, "Why Governments Should Invest More to Educate Girls," *Journal of World Development* 30, no. 2 (2002): pp. 207–225.

11. King and Mason, *Engendering Development*, pp. 158–159.

12. UNPF and PRB, *Country Profiles for Population and Reproductive Health: Policy Developments and Indicators* (United Nations Population Fund / Population Reference Bureau, 2003), p.147.

13. *Ibid.*, p.101.

14. World Bank data from OECD countries show a weak negative correlation between unemployment and female labor force participation. Data from the Middle East show a stronger negative correlation. See Nadereh Chamlou, *Gender and Development in the Middle East and North Africa: Women in the Public Sphere* (advance edition, World Bank, 2004), p. 68.

15. Microfinance institutions charge interest of as much as 40 percent to cover their high costs of making small loans to the poor in rural areas.

16. Abdullah Ahmed An-Na'im, *Toward and Islamic Reformation: Civil Liberties, Human Rights and International Law* (Syracuse: Syracuse University Press, 1990); Khaled Abou El Fadl, *Speaking in God's Name: Islamic Law, Authority and Women* (Oxford: Oneworld Publications, 2001).

17. The proposed law has yet to be presented to the provincial parliament.

18. Charles Kennedy, "Islamization and Legal Reforms in Pakistan. 1979–1989," *Pacific Affairs* 63, no. 1 (spring 1990): pp. 62–77.

19. Because women have been held for extended periods of time on charges of Zina after they reported rape (but before conviction), the Commission concluded "that the majority of the women in jails are there due to the Zina Ordinance." Commission report quoted by Khawar Ghumman, "88pc Women in Jails Due to Flaws in Hudood Ord," *DAWN*, October 8, 2003.

20. Charles Kennedy has argued that Zia's Islamic reforms were largely

“political noise.” Despite strong rhetoric, they were not forcefully implemented and in practice were largely “anemic.” Their impact on Pakistan’s institutions has therefore been minimal. He has also argued that there has been no significant discriminatory bias against women in the implementation of the Hudood Ordinances. See Kennedy, “Islamization and Legal Reforms in Pakistan, 1979-89”; Charles Kennedy, “Islamization in Pakistan: Implementation of the Hudood Ordinances,” *Asian Survey* 28, no. 3 (March 1988): pp. 307-316.

21. UNPF and PRB, *Country Profiles for Population and Reproductive Health*, p. 146.

22. Christopher Nadeem, “Pakistan: Activists Say ‘Virtue Police’ Will Resemble Taliban,” *Global Information Network*, June 9, 2003.

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29. Zeba A. Sathar et al., *Adolescents and Youth in Pakistan 2001-02: A Nationally Representative Survey* (Islamabad: Population Council, 2002), p. 30; United Nations Development Programme, *Human Development Report 2003* (Oxford: Oxford University Press, 2003), p. 256.

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## Islamization, the State and Development

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The central issue in Pakistan's politics has been the expansion of state power and social resistance to it. In Pakistan this process has both encouraged Islamic consciousness and has been facilitated by it. In the economic sphere this process is most clearly evident in the role of Islamization in the politics and management of redistribution. It is here that expansion of state capacity has impacted both Islamic activism and the status of the economy and society. Hence Islamization and its impact on the economy should be examined in the context of the vicissitudes of expansion in the powers of the Pakistan state and its attempts to penetrate the society.

Redistribution refers to those policies that seek to alter the direction of flow of resources and wealth in society with the aim of promoting social justice and more equitable economic relations between social classes. As a state implements redistributive policies, its capacity grows, and by implication, its penetration of society deepens. The growing capacity of the state alters the balance of relations between the state and those social forces that it will touch, and hence, in itself, becomes a bone of political contention. The result is that the state will face opposition to its policies and a decline in its legitimacy. Policies adopted to stave off the political crises that economic

development brings about can in fact augment them. In Pakistan the state has sought to deal with this issue by appealing to Islamic symbols, not only to shore up state legitimacy but to give a favorable identity to its redistributive policies, and to create an acceptable patrimonial order and/or welfare system. The state's sponsorship of Islamization is directly tied to its management of the redistribution of resources and growth of state capacity.

This has encouraged the political opposition to also mobilize along religious lines. Islamic activism here directly reflects tensions born of contending with constraints facing state policies, and more specifically, the state's redistributive efforts. It is not necessarily a product of opposition to state ideology, although in time it has adopted such a posture. The weakness of the state and the ability of sociopolitical forces to influence the state's redistributive policies reinforce the Islamization of politics. Social resistance has limited the scope and effectiveness of the state's redistributive efforts, and by so doing has forced the state to look to other avenues for implementing its reformist policies, which has in turn led to Islamizing patterns of sociopolitical change.

In Pakistan the most obvious target of redistributive policies has been land reform. Although there are other issues of concern such as urban poverty, backwardness of small provinces, and disparities in the wealth of different regions and ethnic groups, none are as important or affect as many Pakistanis directly as the deepening of rural poverty. Amelioration of rural poverty inevitably involves the issue of land reform. Given the state's dependence on the landed elite, land reform has not been implemented in the country in a meaningful fashion. Ayub Khan (1959-69) and Z. A. Bhutto (1971-77) introduced only modest land reforms—after the two land reforms of 1959 and 1972 still 30 percent of Pakistan's farm lands were owned by 0.5 percent of the landowners. General Zia ul-Haq (1977-88) did not even entertain the idea. To compensate for this shortcoming the state has sought to promote equity through other channels, including taking over religious lands and endowments, and the collection of religious taxes and distribution of the proceeds. By the end of the 1980s, the distribution of religious taxes approximated the level of all government subsidies, which shows how central Islamization measures have become to the state's redistribution policies.

“Islamization” of redistribution—creation of an Islamic patrimonial and/or welfare system—has by itself Islamized national politics to the

advantage of Islamic groups. Still, the state's encroachment into the territory of the religious establishment has provoked an Islamic opposition to the state. Islamic parties have openly challenged the state's intrusion into their domain, and have also used the situation to augment their power by demanding concessions. The tensions born of this process have played themselves out in the political arena with the result of placing Islam—and the struggle for controlling its interpretation and application—at the center-stage of national politics. In the political arena the Islamic opposition has received support from the middle and lower middle classes, as well as the country's industrial leaders and entrepreneurs, all of whom pay the lion's share of taxes and are unhappy with the current redistributive measures—even though they have benefited from the pro-industry policies of the state.

At the heart of land reform was the attempt by the state to subdue a powerful social organization that predated the state. To do so, the state has been compelled to look to Islam for legitimacy and authority, and to support its vision of an alternate patrimonial and/or welfare system. The landed elite, too, resorted to Islam to create a strong resistance to state policy.

Throughout the 1950s, the landed elite resisted attempts at land reform by mobilizing religious support for its position. The Islamist party, Jama'at-i Islami (the Islamic Party), helped galvanize support for the landed elite by underscoring the sanctity of private property in Islam. The alliance was able to undo the government's plans. Obversely, the problems of rural poverty and the socioeconomic position of the landed elite also elicited a response from Islamic groups. In 1952-53, food shortages in Punjab which were created by the landlords who sought to increase the price of grain, led to wide scale protests that were orchestrated by the Islam League and the Society of Free Muslims (Anjuman-i Ahrar-i Islam). The agitations culminated in sectarian riots, which in turn led to Pakistan's first martial law in 1954. State policy too has contributed to this trend as it has sought to force through structural changes under the guise of Islamization, most notably during the Zia period.

Soon after the 1959 land reform bill, the state began to nationalize religious endowments and distributive institutions. This policy was formulated by the avowedly secularist Ayub Khan regime. It may therefore have had the intent of weakening the religious forces. But at a more fundamen-

tal level, it was a consequence of the state's failure to subdue the landed elite, and its desire to instead create an Islamic patrimonial system, which would allow the state to receive loyalty in return for its provision of goods and resources, all within the framework of the cultural and ideological language of the masses, and ultimately as a substitute for the system of control exerted through the landed elite and their structure of authority. From this point on, as it will become evident below, the two aims of finding means of promoting greater redistribution of resources and anchoring the state in an Islamically based structure of authority become central to all state policies concerning Islam.

The control of distributive services attached to the nationalized religious institutions would furthermore increase state capacity and reach in place of that of segments of the landed elite, compensating for the shortcomings of the land reform measures. In fact, the state began to actively redefine the social function of religious shrines, as locations for disbursement of social services rather than foci of religious charisma—underscoring the fact that expanding distribution was a central aim of state policy. The state's objective was instituted in the West Pakistan *Waqf* (lit. endowments) Properties Ordinance of 1959, and the creation of the Endowments Department in 1961.

The government's policy affected the hereditary keepers of Sufi shrines, the *sajjadah-nishins*, who were often also large landlords, most directly. Still, the ulama and Islamic parties viewed the government's intrusion into the religious domain with alarm. The state had taken over the distributive networks that were managed by the landed *sajjadah-nishins*, hoping to consolidate its power over distribution of resources to the poor. Ulama and Islamic activists viewed the extension of the state's reach into the religious domain as a graver danger than the "heterodox" practices of the *sajjadah-nishins*.

The consequence was to create greater opposition to the state. The intrusion of the state into the religious domain galvanized a resistance. The issue here was not the reformist aims of the government but the increase in its capacity at the expense of the religious establishment. The resistance was organized by autonomous Islamic associations and parties. The result was that national politics became Islamized, and Islamic parties became an important component of the opposition to Ayub Khan's rule. State-society relations soon became focused on questions of secularism and Islamization.



During the Z.A. Bhutto era, wide scale nationalizations increased state capacity even further. This too provoked an Islamic response, although Bhutto had not directly infringed on the power and position of the religious establishment. In alliance with those whom nationalization had affected—the industrialist and landed elite, but also the middle and lower class and the small landowners—Islamic parties opposed the expansion of state capacity and the shape that it had taken, and sought to prevent it from progressing any further. The problems that faced Pakistan's economy in the wake of Bhutto's nationalizations no doubt made the expansion of state capacity unpopular. Moreover, Bhutto's inability to increase extraction of surplus to support redistribution forced him to rely on inflow of funds from Persian Gulf states. This also forced him to play down leftist politics and to become amenable to Islamizing the national political discourse.

The Bhutto regime fell to a military coup which established its authority by closely allying itself with the Islamic opposition to Bhutto. General Zia became the patron of Islamization in Pakistan and for the first time in the country's history, opened the bureaucracy, the military, and various state institutions to Islamic parties. The close alliance between the military and the Islamic parties, however, did not alter the structure of state-society relations. The landed elite continued to wield power, and the state dithered in undertaking fundamental reforms. The problem of social resistance to redistribution, however, continued to confound the state and push it toward Islamization.

Zia was under pressure from those who had brought down the PPP government to undo Bhutto's populist policies. Zia was not keen on such a move, lest it lead to social upheaval. During his rule only a token number of industries would be handed over to the private sector. To contend with the powerful anti-Bhutto alliance he instead adopted their demands for Islamization—accepting their ideological position while dragging his feet on carrying out their socioeconomic demands. Islamization was therefore the means of contending with the anti-populist agitations while establishing his rule through the very political forces that spear-headed it. Zia also found it prudent to introduce new redistributive policies under the guise of Islamization—to use the ideology of the anti-Bhutto alliance to get their consent for new reform measures. In the least, this policy aimed to draw a wedge between the landed elite and the Islamic forces,

and thus to give the regime room to maneuver. In fact, during the first years of his rule (1977-84), Zia co-opted Islamic forces to balance the power of the landed elite.

As part of the Islamization package, however, Zia sought to introduce a number of distributive programs. These were designed both to aid the poor, and to consolidate the state's control over Islamic institutions—a continuation of the policy first introduced by Ayub Khan in 1959. This control would extend the state's presence to the private sphere.

The most notable measure in this regard was the state's compulsory collection of religious taxes, *zakat* and *ushr*. *Zakat* is one of the five pillars of Islam; every Muslim is obligated to pay 2.5 percent of his savings or accumulated wealth annually to the poor. *Ushr* is an agricultural tax levied on produce of land. The manner in which the contribution is made is entirely up to the individual Muslim, although Muslims generally view the collection of these taxes to be the duty of an "Islamic government"—when and if such a government comes into existence. Zia entrusted the state to collect and distribute *zakat* and *ushr* funds, and made them compulsory. By taking over the collection and distribution of religious taxes he also bolstered the claim of his regime to be truly Islamic. The general saw the taxes as the cornerstone of an Islamic welfare system. Moreover, in the case of *ushr*, the state had finally introduced an agricultural tax, but after disguising it as an Islamic tax. Islamization therefore provided the state with some leverage, if not a convenient cover, in carrying out some of the measures that had been effectively resisted before.

The state's takeover of the collection and distribution of religious taxes was aimed at improving social welfare, but also to help the government's budget deficits. In fact, since 1988 *zakat* and *ushr* funds have been officially integrated into the government revenue accounts. The contribution of these taxes to state revenue is modest, but they represent an increase in tax revenues, filling in for taxes that ought to be collected directly and are not. Although direct tax rates are quite high—60 percent for individuals in the highest bracket and 65 percent for companies—tax revenue recovery remains quite modest. Evasions of income and corporate tax are common, and the agricultural sector has been exempt from income tax. In recent years direct taxes have made up only 13-18 percent of the tax revenues.

The government's takeover of religious tax funds was politically problematic. Even those Muslims who accept the right of an Islamic govern-

ment to collect religious taxes were not reconciled to the military regime's collection of those taxes. Zia's policies were seen as a direct assault against the social and economic position of the religious establishment, which in turn found an incentive to question the Islamicity of his regime with a view to denying it the right to collect religious taxes. Mufti Mahmud, a prominent religious leader and advocate of Islamization, went so far as to order his followers not to receive government subsidies that came from *zakat* funds, lest they compromise the autonomy of his seminaries. The Islamic state thus produced an Islamic opposition. Given the fact that Zia's initiative closely followed the rhetoric of the Islamic activists, they were hard-pressed to challenge him directly on the issue of religious taxes. As a result, they questioned state authority by opposing government policy on a host of other issues. The consequence was that the scope of Islamic activism and the extent of its opposition to the state increased.

To minimize opposition to the state's actions, Zia included Islamic parties in the drafting of new *zakat* and *ushr* laws and sought to assuage them by opening various state resources to them. Still, the religious taxes proved to be a thorny issue in other ways as well. First, the government converted *zakat* from charitable alms to a formal state tax, and thus discouraged savings which would be taxable through *zakat*. The new *zakat* laws stipulated that all Muslim citizens who had at least 2,000 rupees of certain kinds of assets would have to pay *zakat*. The individual was no longer involved in the calculation of the taxes as was the case previously, nor would he/she have a say in how the revenues would be spent. Such decisions were now made by the bureaucracy that General Zia set up to oversee the collection and distribution of the religious taxes. Second, the burden of the tax by and large fell on the middle and lower middle classes, whereas the rich did not, and do not, contribute their fair share to the system. When the government's proposed budget in June of 1996 envisioned new sales and income taxes but introduced no agricultural taxes, it confronted demonstrations in several urban areas, one of which resulted in the death of four people.

Third, the government met stiff resistance from the Shi'i community of Pakistan, which numbers between 15-25 percent of the population. The Shi'i refused to pay their *zakat* to a Sunni government instead of Shi'i ulama. Their agitations forced the government to capitulate and exempt them from compulsory *zakat* donations, but only after the Shi'i commu-

nity was politicized and the general's allies among the Sunni Islamic activists had developed an anti-Shi'i posture. The fact that the government capitulated to the demands of the Shi'is and exempted them from *zakat* collection led more and more Pakistanis to declare themselves as Shi'is. This had the effect of hardening anti-Shi'i attitudes among Sunni Islamic activists. State policy therefore intensified sectarian conflict, which has since 1988 become one of the most visible religio-political axes of conflict in the country.

Nor were the poor terribly enamored with the general's scheme. Compulsory collection of religious taxes reduced the levels of voluntary contributions to the poor, who now had to deal with the bureaucracy to receive support. The bureaucracy which oversees the collection and distribution of religious taxes has strict criteria for disbursing its funds. These criteria at face value appear to have streamlined the circulation of religious taxes and have the trappings of an efficient welfare system. At closer examination the bureaucratization of the circulation of religious taxes clearly disfavors those it intends to serve. In addition, less and less of the tax funds have been going to the poor, and more and more to state coffers. A large proportion of the tax funds have in fact been used to subsidize pilgrimages to Mecca. The stipends handed out by the *zakat* committees are generally below what a family requires to subsist, 50-100 rupees a month per individual (\$2.30-4.80) and 100-150 rupees (\$4.80-7.10) a month for head of a family. The state in effect expects the recipients to supplement their income, although it will not allow them to beg and has no provision to help those who are unemployed or unable to work. Although the tax funds, which in 1988-89 were approximately \$500 million, could benefit 65 percent of eligible families, only 10 percent of those below the poverty line in fact receive disbursements. Currently the disbursements account for less than 0.5 percent of the GDP, which shows how meager the state welfare programs are.

The *zakat* and *ushr* laws may have helped the state's revenues and to a modest extent contributed to its provision of social welfare, but only after exacting a steep political cost in terms of entrenching Islamization in state policy and national politics, fanning the flames of sectarian conflict, and expanding state capacity.

Eventually the increase in the capacity of the state through Islamization would also bring about tensions in the relations between the state and its

Islamic allies. The Islamic parties were increasingly unhappy with the increase in the state's control of Islamic institutions. The Islamic parties also wanted more from the regime for their support than the general was willing to countenance. The state, which still needed to do more for the poor and had now antagonized the Islamic forces, was once again compelled to rely on the landed elite to exert social control. From 1985 onwards, with the rise to power of the landlord-dominated Muslim League and the appointment of the Sindhi landlord, Muhammad Khan Junejo, as prime minister, the landed elite became Zia's most important instrument of social control. The upshot was that, between 1977 and 1985, the state increased its capacity somewhat and penetrated new social arenas under the guise of Islamization, but it proved unable to achieve its principal goal of freeing itself from dependence on the landed elite and pushing through meaningful reform. In the process, however, the state did succeed in entrenching Islamization in Pakistan.

In summary, it is important to note that Islamization has been a manifestation of deep-seated struggles between the weak and developing Pakistan state and powerful social forces. As such, Islamization's impact on Pakistan's economy must be gauged in terms of the extent to which it has facilitated the state's penetration of the society and control of the economy. Islamization's impact on the economy is therefore not separate from the state's impact on the economy. The key issue is not just Islamization's impact on Pakistan's economy, but the impact of the state's strategies of penetrating and controlling social forces and the economy on the Islamization of politics. As the Pakistan state embarks on its most ambitious effort yet to penetrate the economy under the Musharraf regime, it is bound to encounter resistance and provoke Islamist responses, regenerating the debate over Islamization and state control of the economy.

## Pakistan's Superior Courts and the Prohibition of Ribai<sup>1</sup>

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Islamic activists have long advocated the elimination of *riba* (financial interest) in Pakistan. But their demand has been stymied by Pakistan's political system. After an agonizing nine-year gestation (1947-1956) Pakistan's first constitution was born, but Islamic provisions in the document were intentionally vague or weak. Article 28 of the 1956 Constitution did call for the elimination of *riba* "as early as possible" and the 1962 Constitution provided in the principles of policy that "usury" should be abolished.<sup>2</sup> Similar provisions were reiterated in the 1973 Constitution.<sup>3</sup> But in none of these instances were attendant mechanisms introduced designed to realize such objectives.

The Council of Islamic Ideology (CII), established by the 1962 Constitution as an advisory body, made numerous recommendations during the 1960s that *riba* should be eliminated in Pakistan, as *riba* was "forbidden" by Islam and Pakistan's banking system was "fundamentally based upon *riba*." Such views were unanimously adopted by the CII in its meeting of December 3, 1969.<sup>4</sup> In subsequent meetings the CII drafted a

report, submitted to the government in 1971, that, *inter alia*, recommended the abolition of *riba*.<sup>5</sup> Such recommendations seem to have had no formal public consideration by the regime of Zulfikar Ali Bhutto, or by the other framers of the 1973 Constitution.

It was not until General Muhammad Zia ul-Haq assumed power as Chief Martial Law Administrator in July 1977 that the issue of *riba* gained center stage in Pakistan's policy arena. After reconstituting the CII (the CII had largely been defunct during Bhutto's tenure), he directed the new membership of the Council on September 29, 1977, to consider how best to "eradicate the curse" of interest from Pakistan. The Council responded by appointing a commission of economists and bankers to examine the issue, which in turn duly submitted an "interim report" to CMLA Zia in late 1978. Apparently on the basis of this report,<sup>6</sup> Zia directed that the Home Building Finance Corporation and the Investment Corporation of Pakistan were to be run on an interest-free basis through the adoption of profit-loss sharing (PLS). Also, in a nationwide broadcast on February 10, 1979, Zia announced wide-ranging Islamic reforms in Pakistan's legal system, including the adoption of the *hudood* ordinances, and promised that interest would be completely abolished in the state within three years.

Five months later the CII issued its long-awaited "final" report on the "elimination of interest from the economy." The report, authored by Dr. Tanzil-ur-Rehman, recommended detailed and far-reaching reforms that, if implemented fully, would have resulted in the complete elimination of financial interest in Pakistan by July 1982.<sup>7</sup>

Zia's government responded to the Council's report by replacing interest-bearing savings accounts with PLS instruments in Pakistan's five state banks. Also, the government introduced and encouraged such banks to adopt financing schemes based upon the principles of *mudarabah* and/or *musharaka*.<sup>8</sup> However, the specific implementation of such reforms was left up to the respective boards of the individual banks. In most instances the banks opted to offer alternative financial instruments to their customers—those that offered fixed interest rates and those that offered a non-interest component.

Such modes of implementation fell far short of the ideals contemplated by the CII. Indeed, the CII's 1980 report had specifically cautioned against creating alternative banking windows as this would be "extremely

dangerous [and] likely to entail perpetuation of the interest-based system.”<sup>9</sup> Moreover, after Zia had introduced such cosmetic changes, zeal for further reforms of financial practices quickly waned. In part this was owing to the firestorm of domestic opposition generated by the dissemination of the Council’s report. More important, however, it was linked to Zia’s overall strategy to go slow with the pace of Islamic reform. Zia could honestly claim, as he often did during the remainder of his life, that he had introduced Islamic reforms that were designed to combat the scourge of *riba*. But the banking reforms that he implemented did not seriously challenge the operations or the corporate interests of domestic banks or Pakistan-based affiliates of multinational banks.

Zia’s policy of prudential, incremental Islamic reform was also demonstrated by jurisdictional limitations imposed upon the newly-created Federal Shariat Court (FSC). On June 26, 1980, Zia constituted the FSC, empowering the court to declare a “law void if found repugnant to the injunctions of Islam as laid down in the Holy Quran and Sunnah.” However, very significantly he excluded from the FSC’s jurisdiction

*...the Constitution, Muslim personal law, any law relating to the procedure or any court or tribunal, or until the expiration of three years from the commencement of this chapter [3-A June 25, 1980] any fiscal law or any law relating to the levy and collection of taxes and fees or banking or insurance practice and procedure.*<sup>10</sup>

Clearly, Zia’s intent was to prevent the FSC from challenging any fiscal laws on the grounds of Islam’s prohibition against *riba* until such time as his government deemed appropriate.

Blocked by the political machinations of Zia, Islamic activists have adopted a well-designed and creative strategy to gain passage of their policy agenda. This strategy consists of a combination of: (a) public education designed to gain popular acceptance of the advisability and viability of an interest-free economy; (b) the passage of legislation which would revise Pakistan’s constitutional structure, by making the *shariah* superior to Pakistan’s constitution; and (c) the encouragement of Pakistan’s superior courts (particularly the FSC and the Supreme Court) to take an activist approach in defining their respective jurisdictions to entertain constitutional questions relevant to matters “repugnant to Islam,” including *riba*.



This paper will focus on the convoluted history of the latter approach by examining the role of Pakistan's superior courts in the *riba* issue.

## THE OBJECTIVES RESOLUTION AS SUPRA-CONSTITUTIONAL

The Constituent Assembly of Pakistan passed the Objectives Resolution in 1949. The Resolution was designed, in part, to serve as a framework for the drafting of Pakistan's first constitution, an exercise that proved agonizingly difficult. It contained the following provisions dealing with Islam:<sup>11</sup>

*The government of Pakistan will be a state...wherein the principles of democracy, freedom, equality, tolerance and social justice as enunciated by Islam shall be fully observed; wherein the Muslims of Pakistan shall be enabled individually and collectively to order their lives in accordance with teachings and requirements of Islam as set out in the Holy Qur'an and Sunnah.*

It took nine years from Partition for the Second Constituent Assembly (the first was dismissed in 1954) to finally agree upon a draft of a constitution. To those advocating the adoption of an Islamic constitution, the resultant 1956 document was disappointing. Indeed, the Objectives Resolution was relegated to the status of a preamble. Similarly, the Objectives Resolution was included merely as a preamble in the 1962, interim 1972, and 1973 constitutions.

The issue whether the Objectives Resolution as preamble provided a basis to challenge other provisions of Pakistan's constitution was answered clearly and unequivocally in 1973 by the Supreme Court in the *Zia-ur-Rehman* case.<sup>12</sup> In its decision the court ruled that the Objectives Resolution as preamble does not hold sway over the "normal written constitution."

*As a preamble to the constitution, then it will serve the same purpose as any other preamble serves, namely in the case of any doubt as to the intent of the lawmaker, it may be looked at to ascertain the true intent, but it cannot control the substantive provisions thereof.<sup>13</sup>*

Nevertheless, would-be Islamic reformers looked to the newly-created FSC to seek redress. Accordingly, numerous Shariat petitions were filed

with the FSC challenging provisions of various laws which sanctioned the payment of financial interest. The court as per Justice Aftab Hussain, however, dismissed such petitions collectively on the grounds of lack of jurisdiction. In *Essa E.H. Jafar*, Justice Hussain found that any law concerning interest was by definition a “fiscal law” and hence was excluded from the FSC’s jurisdiction by Article 203-B [quoted above].<sup>14</sup> The exclusion of the FSC’s jurisdiction to deal with any fiscal law originally was set to expire within three years, that is, by June 25, 1983. However, the time limit was extended three times by President Zia—first to four years, then to five years and finally to ten years.<sup>15</sup> Therefore, the *Jafar* ruling effectively banned the FSC from the consideration of laws relevant to *riba* until 1990.

In 1985, the “restored constitution” of President Zia incorporated the text of the Objectives Resolution into the body of the constitution as Article 2-A. This action provided further scope for Islamic activists and provided a context for an expansive role for the superior courts. In 1987, Dr. Tanzil-ur-Rehman, now a judge of the Sindh High Court, articulated a judicial doctrine that integrated the Objectives Resolution (Article 2-A) of the 1985 Constitution as the *grundnorm* of Pakistan’s constitutional structure. In brief he reasoned that superior courts possess the jurisdiction to examine laws, even if such laws are protected by the constitution, on the grounds that such “protected laws” may violate the principles of the Objectives Resolution. That is, even though the FSC is constitutionally prohibited from considering fiscal laws by Article 203-B, the high courts, including the Sindh High Court, are not, as such fiscal laws arguably violate the Objectives Resolution.

On the basis of this reasoning, Justice Tanzil-ur-Rehman claimed standing for the Sindh High Court to consider three cases in which the validity of *riba* was challenged. In *Bank of Oman vs. East Trading Company*, he granted leave to appeal an impugned decision of a district court pertaining to bank interest on the grounds that the High Court had jurisdiction through Article 2-A to construe the existing law in light of the Holy Qur’an and Sunnah, except when a specific law falls within the exclusive jurisdiction of the FSC.<sup>16</sup> This decision was clarified in the *Irshad Khan* case.<sup>17</sup> In the latter relief was granted to the petitioner against the collection of interest on a private note. Similarly, in *Habib Bank vs. Muhammad Hussain*<sup>18</sup> Justice Rehman invoked Article 2-A to enable the High Court to examine the question of bank interest; and as before found its collec-

tion un-Islamic. Support for Justice Rahman's doctrine was subsequently provided in other High Court Decisions.

Theoretically, the creative use of Article 2-A in the hands of a would-be Islamic judicial activist could provide a mechanism to significantly transform Pakistan's legal structure.<sup>19</sup> But the *riba* issue became joined by a confluence of much more mundane factors during the following year. First Benazir Bhutto's government neglected to extend the date banning the FSC's consideration of fiscal law, as per Article 203-B, beyond June 25, 1990.<sup>20</sup> Therefore, the FSC could subsequent to that date examine "fiscal law" for repugnancy to Islam. Second President Ghulam Ishaq Khan employed Article 58 (2)(b) to dismiss Benazir Bhutto's government in August 1990. Benazir was a self-styled opponent of "Zia's Islamization program." And third, President Ghulam Ishaq called Justice Tanzil-ur-Rehman out of retirement (he had retired from the Sindh High Court in June 1990) and appointed him as Chief Justice of the FSC on November 15, 1990.

### **MAHMOOD-UR-REHMAN FAISAL V. SECRETARY, MINISTRY OF JUSTICE**

One of the first acts of the newly-appointed Chief Justice of the FSC was to publicly announce through a decision rendered on January 13, 1991, that the FSC was now in a position to entertain Shariat petitions challenging fiscal legislation. The court was swamped with such petitions. A total of 115 Shariat petitions were filed between June and October 1991 challenging twenty separate laws as repugnant to Islam on the grounds that they countenanced the practice of *riba*. The overwhelming majority of such petitions relied upon the Qur'an (especially 2:275-78) to substantiate their arguments. Such petitions found a sympathetic ear in Tanzil-ur-Rehman and the court.

Accordingly, in November 1991, a three-member bench of the FSC rendered a landmark decision, authored by the Chief Justice that totaled 188 pages.<sup>21</sup> The *Faisal* decision granted relief to the overwhelming majority of the petitioners by declaring provisions of twenty federal and provincial laws dealing with *riba* as repugnant to Islam, and ordered their revision by July 1, 1992. The main findings of the court are summarized below:

- *Riba* means any “addition, however slight, over and above the principal,” and includes both usury (excessive interest), as well as market-based or government-regulated interest.
- No legal distinction can be made between “productive loans” and “consumption loans.” The prohibition against *riba* is absolute; there is no difference as to the basis of the purpose or nature of the loan.
- Qur’anic decrees regarding *riba* are not allegorical. Rather they constitute part of the clear text (*nass*) of the Qur’an.
- The prohibition of *riba* does not counter the public good. *Ijtihad* regarding the public good is only relevant when there is no textual precedent (*nass*) found in the Qur’an.
- The indexation of loans in order to control inflation is prohibited by Islam. The Qur’an considers money a commodity; it must be exchanged in kind, not value.
- Any system of mark-up is repugnant to Islam because it is tantamount to financial interest.

The *Faisal* decision left the Nawaz Sharif government in a very difficult position. Prime Minister Sharif’s main domestic policy initiative after he assumed office in late 1990 was the liberalization of Pakistan’s economy, an initiative which was clearly threatened by the *Faisal* ruling. Second, the government and Nawaz Sharif personally were on record as committed to pursuing the goal of Islamization. Therefore, the Prime Minister was caught between a rock and a hard place. If he embraced the *Faisal* decision, he would risk the ire of the domestic and international business community (his most important constituency); if he stonewalled the decision, he would risk being charged with departing from his party’s agenda and could be charged with being “un-Islamic.” Faced with such a dilemma he chose the path of least resistance. Nawaz “encouraged” the public sector Agricultural Development Bank to file an appeal before the Shariat Appellate Bench of the Supreme Court (SAB) challenging the *Faisal* decision.

This appeal lay dormant with the SAB for over five years. To those opposed to the implementation of the *Faisal* decision (Nawaz' governments; Benazir Bhutto's second regime; the business community; the overwhelming majority of the civil and military bureaucracy; most of the justices of the superior judiciary; and so forth) it was far better for the case to remain *sub judice* than to be decided. It was the considered opinion of most of those knowledgeable with the issues that once it heard the appeal, the SAB would be hard-pressed to overturn the FSC's decision. First, the *Faisal* decision was carefully, if eccentrically, crafted; and the court had dismissed the government's petitions during the hearing (presented by talented high-profile attorneys representing the State Life Insurance Company, the National Bank of Pakistan, and the Banking Council of Pakistan) in painful detail in the judgment. It was unlikely that the Agricultural Development Bank could array a wholly new set of arguments. Second, the SAB attracted jurists who lean towards Islamic activism. That is, overturning the *Faisal* decision would be a hard sell to a less than sympathetic audience.

Therefore, both the first Nawaz Sharif government and the successor Benazir Bhutto government did not press for a resolution of the appeal, and relevant Chief Justices of the Supreme Court were reluctant to reopen the issue either. It is very likely that the *Faisal* decision would have remained indefinitely in such a judicial limbo if it had not been for the all-too-public rift that developed between Nawaz Sharif and the superior judiciary (particularly the then Chief Justice of the Supreme Court, Sajjad Ali Shah) following Nawaz' orchestrated passage of the Thirteenth Amendment. The passage of the Thirteenth Amendment (April 1997) both weakened the office of the presidency and significantly narrowed the authority of the Supreme Court. Functionally, the "Article 58 (2) (b) system" gave the president the power to dismiss the prime minister subject to the concurrence of the superior judiciary. Therefore, in matters of succession the Supreme Court had in effect become co-equals to the other branches of government. Chief Justice Sajjad Ali Shah was opposed to the passage of the Thirteenth Amendment, and it was rumored that he would lead the charge to have the amendment declared unconstitutional (something he later unsuccessfully attempted). It was also rumored that he was threatening to move the dormant *Faisal* appeal to the head of the queue (the Chief Justice controls the court's docket) of the SAB.

Ostensibly, in an attempt to head this off, Nawaz Sharif orchestrated a three-pronged counter-strategy in July 1997. First, he sought to withdraw the government's appeal from the consideration of the SAB. Second, he attempted to submit a fresh appeal of the *Faisal* decision to the FSC. This was summarily dismissed by the FSC as the case was still under appeal before the SAB.<sup>22</sup> Third, he submitted a formal petition to the Supreme Court requesting the court to provide "authoritative answers" to three "serious questions" concerning the implementation of the *riba*-less financial system: 1) How should the government deal with foreign obligations?; 2) How would the implementation of the *Faisal* decision impact the viability of Pakistan's banking system?; and 3) How could the issue of inflation be dealt with in the context of an interest-free system?<sup>23</sup> Obviously, the government's goal was to occasion delay. Sajjad Ali Shah, in no mood to cooperate with the government, dug in his heels and refused the government's requests, ordering that the appeal be heard forthwith.

#### **M. ASLAM KHAKI V. SYED MUHAMMAD HASHIM**

Once the process got started in earnest, it took the court nearly two years to dispose of research and procedural issues before finally scheduling hearings. The case was heard in thirty-odd sessions before the full bench of the SAB starting on February 22, 1999, and extending to July 6. It was a monumental undertaking—literally hundreds of lawyers and experts participated in the process and ultimately the decision disposed of 55 appeals against the *Faisal* decision.

The judgment proved to be equally monumental. The court's decision consisted of the Court's Order co-authored by Justices Khalil-ur-Rehman and Munir A. Sheikh, and three concurring opinions rendered by Justices Khalil-ur-Rehman, Wajihuddin Ahmed, and Muhammad Taqi Usmani. In sum the judgment is 534 pages long. However, despite its length and seemingly endless discussion of the merits of dozens of sometimes relevant arguments, the conclusion is quite straightforward; the SAB fully upheld the *Faisal* decision.<sup>24</sup> Moreover, the SAB's decision supported the six points listed above that defined the FSC's earlier decision. Most importantly, *Aslam Khaki* upheld the FSC's expansive definition of what constitutes *riba*:

*A transaction of money for money of the same denomination where the quality on both sides is not equal, either in a spot transaction or in a transaction based on deferred payment.*

And, it applied this definition to all forms of bank interest:

*...all the prevailing forms of interest, either in the banking transactions or in private transactions do fall within the definition of riba. Similarly, any interest stipulated in the government borrowings, acquired from domestic or foreign sources, is riba and clearly prohibited by the Holy Qur'an.*

Accordingly, the SAB dismissed all of the appeals filed against the *Faisal* decision and ordered that the government would have to bring the offending sections of thirteen of the twenty laws which had been impugned in the earlier decision into conformity with the requirements of Islam, substituting, in the words of the court, “*riba*” with “*shari’ah* compliant return.” Such laws would have to be brought in conformance with Islam by June 30, 2000. The SAB also ruled that the seven other laws impugned by the *Faisal* decision would cease to have legal effect after March 31, 2000.

Also of great importance, the court in its Order offered “concrete” procedures for the government to follow in order to prepare to implement a *Shari’ah* compliant regime. Specifically, the court directed:<sup>25</sup>

- That within one month the State Bank of Pakistan constitute a “high-level commission” fully empowered to carry out and supervise the process of transformation of the existing financial system to one conforming to *Shari’ah*. This commission would be called the “Commission for Transformation.”
- That within two months the aforementioned commission would “chalk out a strategy” to implement the Raja Zafarul Haq Commission’s report.<sup>26</sup>
- That within one month the Ministry of Law would comprise a task-force empowered to: a) draft a new law for the prohibition of *riba*; b) review existing financial and other laws to bring them into conformity

with Islam; and c) to draft new laws to give “legal cover” to the new financial instruments.

- That within six months all banks and financial institutions prepare their model agreements and submit them for approval before the Commission for Transformation.
- That all joint stock companies, mutual funds and firms with an aggregate income of 5 million rupees or more annually subject themselves to independent audits.
- That all banks and financial institutions shall thereafter arrange training programs and seminars to educate their respective staffs in the new laws.
- That within one month the Ministry of Finance would form a task force which would devise mechanisms to convert domestic borrowings into project-related financing.
- That domestic inter-governmental borrowings and borrowings from the federal government from the State Bank of Pakistan be converted to an interest-free system.
- That a “serious effort” be made by the federal government to relieve the nation from the burden of foreign debts and to renegotiate the existing loans. Future borrowings should also be based on Islamic modes of financing.

The decision was announced on December 23, 1999, some two months after the military coup which brought General (later Chief Executive and ultimately President) Parvez Musharraf to power. Effectively, of course, the Order of the Court and its timetable was only advisory to the Chief Executive. Under the Provisional Constitution Order (PCO), the “Supreme Court or High Courts and any other court shall not have the powers to make any order against the Chief Executive or any other person exercising powers or jurisdiction under his authority.”<sup>27</sup> If the PCO was not clear enough, the military government required that all superior court judges take a fresh oath of office in which they would undertake to uphold



the PCO, 1999, or leave office.<sup>28</sup> Six justices of the Supreme Court (including two members of the SAB, Justices Khalil-ur-Rehman and Justice Wajihuddin Ahmed) refused to take the new oath of office and were accordingly deemed to have retired from the bench. The other two members of the SAB (Justices Munir A. Sheikh and Muhammad Taqi Usmani) did take the fresh oath under the terms of the PCO.

Although Chief Executive Musharraf was none too keen to implement the *Aslam Khaki* decision, the specific directives of the SAB left him little room to maneuver. Accordingly, steps were taken to comply with the court's directives, including the establishment of a Commission of Transformation within the State Bank, and the convening of task forces within the Law and Finance ministries. Indeed, the task force within the Ministry of Law actually drafted a law for the prohibition of *riba*—although it was never promulgated.<sup>29</sup> Nevertheless, there remained considerable opposition to the *Aslam Khaki* decision, and in June 2001 the government encouraged and lent assistance to the United Bank Ltd.'s (UBL) appeal challenging the implementation of the decision. The SAB accepted the review petition filed by the UBL occasioning a one-year delay in the implementation of the *Aslam Khaki* directives—until July 1, 2002. And the SAB subsequently entertained the appeal.

### **UNITED BANK LTD. V. FAROOQ BROTHERS**

Given the foregoing narrative the SAB's decision in the *UBL* case is surprising, if not astonishing. For the SAB to reverse its own earlier decision (the *Aslam Khaki* case) required that the court find new and important evidence, or a mistake or error demonstrated in the record of the earlier decision, or other sufficient grounds analogous to the foregoing to justify its reversal.<sup>30</sup> The SAB duly found many "errors" in the *Aslam Khaki* case, including:<sup>31</sup>

- That the SAB did not properly distinguish between the terms "usury," "*riba*," and "interest."
- That the directives made by the SAB in the *Aslam Khaki* case were not "practical" or "feasible" for the government to implement, and, if attempted, would "pose [a] high degree of risk to the economic stability and security of Pakistan."

- That the SAB had failed to distinguish between the “legal and moral aspects” of *riba*.
- That the court misread the commentary of various eminent jurists who had different views regarding the nature of *riba*.
- That the SAB wrongly applied its decision to non-Muslims.
- That indexation is not repugnant to Islam as is held in the *Aslam Khaki* decision.
- That Dr. Tanzil-ur-Rehman, the author of the Faisal decision as well as the chairman of the CII in 1980 when it issued its report on prohibition of *riba*, had a predetermined mind when he authored the *Faisal* decision. The SAB did not take this into account when it issued its decision in *Aslam Khaki*.
- That the SAB did not fully consider all of the jurisdictional issues related to the implementation of its directives.
- That the SAB did not make sufficient allowances for the effects of inflation in determining what constituted *riba*.

The offshoot of this was that *Aslam Khaki* was overturned and the *Faisal* decision was remanded to the FSC, which was directed to correct its errors. In the words of the SAB:

*A case for review of the impugned judgment is made out as there are errors floating on the surface of record....we are of the considered view that the issues involved in these cases require to be re-determined after thorough and elaborate research and comparative study of the financial systems which are prevalent in the contemporary Muslim countries of the world. Since the Federal Shariat Court did not give a definite finding on all the issues involved the determination whereof was essential to a resolution of the controversy involved in these cases, it would be in the fitness of things if the matter is remanded to the Federal Shariat Court which under the Constitution is enjoined upon to give a definite finding on all the issues falling within.<sup>32</sup>*

Obviously, the *UBL* decision totally reversed the *Aslam Khaki* decision—only thirty months after the latter was rendered. It should also be noted, as we have seen, that *Aslam Khaki* in turn was the result of over two decades of research including nearly two years of deliberation before the SAB. What had changed?

One compelling rationale for such a stunning *volte face* was governmental pressure upon the court. It is important to note in this regard that in the weeks prior to the issuance of the *UBL* decision, Justice Maulana Taqi Usmani (former member of the CII and long-term judge of the FSC and SAB) was removed from the SAB and replaced by two ulema judges appointed by President Musharraf—Dr. Allama Khalid Mahmood and Dr. Rashid Ahmed Jullundhri. The removal of Justice Usmani was decried by Islamic activists, as was his replacement by the two latter mentioned judges.<sup>33</sup> It is also important to note that Justice Munir A. Sheikh, a co-author of the SAB's Order in the *Aslam Khaki* case, and the only holdover from the 1999 decision, voted along with his new bench mates to reverse a decision which he had originally helped to author less than two years earlier. One is tempted to cite Oscar Wilde's oft-cited *bon mot*—"consistency is the hallmark of a weak mind." It should also be noted that Justice Munir Sheikh and the other two regular members of the Supreme Court (Chief Justice Sheikh Riaz Ahmed and Justice Qazi Muhammad Farooq)<sup>34</sup> who rendered the *UBL* decision have reached the formerly mandatory retirement age of 65. That is, each has benefited from the three-year extension of service for members of the superior judiciary.

## CONCLUSION

The practical implication of the *UBL* decision is to effectively derail for the foreseeable future the strategy of utilizing the superior judiciary and judicial activism to effect the goal of the prohibition of *riba*. The FSC has been assigned the dubious task of reviewing the *UBL* decision. But it is hard to imagine that the FSC will be able to accomplish this task in the near-term. The FSC's task—to address the numerous "flaws" in the *Faisal* decision as per the *UBL* ruling—is staggering. Moreover, even if one suspends disbelief and assumes that the FSC will somehow be up to the task, any decision of the FSC will be subject to appeal before an unsympathetic SAB.

Those who wish to see a transformation of Pakistan's economic system incorporating Islamic tenets are left with little recourse save trying to convince a heretofore dubious and disinterested public of the merits of the prohibition of *riba* and ultimately to gain passage of relevant legislation in the National Assembly. Of course, this strategy is fraught with numerous difficulties and uncertainties.

## NOTES

1. This is an updated and revised version of Charles H. Kennedy, "Judicial Activism and Islamization After Zia: Toward the Prohibition of Riba," in Charles H. Kennedy, ed., *Pakistan: 1992* (Boulder, Colo.: Westview Press, 1993), pp. 57-73.

2. Number 18.

3. Article 38.

4. Council of Islamic Ideology, *Report of Consolidated Recommendations on the "Islamic Economic System,"* (Islamabad: CII, 1983), pp. 9-10. Hereinafter CII (1983).

5. CII (1983), p. 10.

6. This report was not published. A later version of the report was submitted to the CII in February 1980. It was published as "Interim Report of the Panel of Economists and Bankers on the Elimination of Interest" and was appended to the Council of Islamic Ideology, *Report of the Council of Islamic Ideology on the Elimination of Interest from the Economy* (Islamabad: CII, 1980). Hereinafter CII (1980).

7. CII (1980). Dr. Tanzil-ur-Rehman was Chairman of the CII. The other members of the Council were Maulana Zafar Ahmad Ansari, Khalid Ishaque, Mufti Sayyahuddin Kakakhel, Khwaja Qamaruddin Siyalvi, Maulana Muhammad Taqi Usmani, Maulana Muhammad Hanif Nadvi, Dr. Ziauddin Ahmad, Allama Syed Muhammad Razi, Maulana Shamsul Haq Afghani, and Dr. Khowar Khan Chisti.

8. *Murabaha* is a practice in which the bank purchases, in its own name, goods that an importer or trader wants, and then sells them to him at an agreed mark-up. The technique is used for financing trade, but because the bank takes title to the goods, and is therefore engaged in buying and selling, its profit derives from a real service and entails a

degree, albeit minimal, of risk. *Musharaka* is a practice in which the bank enters into a partnership with a client in which both share the equity capital—and perhaps even management—of a project or deal, and both share in the profits or losses according to their equity shareholding.

9. CII (1980), paragraph 1.32, p. 26.

10. 1985 Constitution, Article 203-B.

11. Adapted from the Constitution of the Islamic Republic of Pakistan as modified up to March 19, 1985 (Islamabad: Manager Printing Corporation of Pakistan Press, 1985), Article 2-A. Hereinafter the 1985 Constitution.

12. *The State v. Zia-ur-Rehman* PLD 1973 SC 49.

13. PLD 1973 SC 75.

14. *Essa E.H. Jafar v. Federation of Pakistan* PLD 1982 FSC 212.

15. As per Presidential Orders no. 7 (1983); no. 2 (1984); and no. 14 (1985).

16. *Bank of Oman Ltd. v. East Trading Company* PLD 1987 Karachi 404. See especially p. 442.

17. *Irshad H. Khan v. Muhammad Hussain* PLD 1987 Karachi 466.

18. *Habib Bank vs. Muhammad Hussain* PLD 1987 Karachi 616.

19. See Charles H. Kennedy, “Repugnancy to Islam—Who Decides?” *International and Comparative Law Quarterly* 41, no. 4 (October 1992), pp. 769-787. It is important to note that support for the “Objectives Resolution Doctrine,” although never a widely-held view among jurists, was provided support by two prominent jurists in the late 1980s—Nasim Hasan Shah and Gul Muhammad Khan.

20. There is compelling evidence to support the contention that Benazir Bhutto’s government did not give adequate consideration to matters pertaining to the Islamization process throughout her first term in office. The government, of course, was publicly committed to rolling back what Benazir often called “Zia’s Islamization Program” but it consistently failed to take requisite actions to delay or contest consideration of various issues pending before the superior courts, e.g. pre-emption, *qisas* and *diyat*, and land reforms. From all available evidence, the failure to extend Article 203-B’s ban on the consideration of fiscal matters was unintentional and in the words of one of the principals an “unfortunate oversight.”

21. *Mahmood-ur-Rehman Faisal v. Secretary, Ministry of Justice, Law and Parliamentary Affairs* PLS 1992 FSC 1.

22. "Government of Pakistan through Secretary of Law and Parliamentary Affairs v. Mahmood-ur-Rehman Faisal." Review petition filed before FSC (June 30, 1977).

23. See *Dawn* (July 1, 1997) for the text of the government petition.

24. Dr. M. Aslam Khaki v. Syed Muhammad Hashim PLD 2000 SC 225.

25. The following are derived from Aslam Khaki v. Syed Muhammad Hashim PLD 2000 SC 345-347.

26. "Report on Elimination of Riba." Raja Zafar-ul-Haq chairman. Unpublished (1997).

27. Provisional Constitution Order no. 1 of 1999 PLD 1999 Central Statutes 446.

28. Oath of Office (Judges) Order 1999 (Order no. 10 of 1999 PLD 2000 Central Statutes) 38.

29. For a discussion of actions taken by the Musharraf government to implement the *Aslam Khaki* decision see Parvez Hassan and Azim Azfar, *Moving Toward an Islamic Financial Regime in Pakistan*. Islamic Legal Studies Program, Harvard Law School. Occasional paper no. 2 (Cambridge: Harvard Law School, 2001).

30. Code of Criminal Procedure, 1908, Section 114.

31. These are derived from the text of United Bank Ltd. v. Farooq Brothers as found in Razaqat Ali, "FSC to decide Riba case afresh; Supreme Court sets aside earlier judgment," *Dawn* (internet edition-25 June 2002).

32. United Bank Ltd v. Farooq Brothers, paragraphs 17 and 18.

33. See for instance Razaqat Ali, "Unruly Scenes mar hearing of Riba petition" *Dawn* (internet edition, June 7, 2002).

34. The members of the bench were Chief Justice Sheikh Riaz Ahmed, and Justices Munir A. Sheikh, Qazi Muhammad Farooq, Dr. Khalid Mahmood, and Dr. Rashid Ahmed Jullundhri. Therefore, the bench consisted of the three most senior justices of the Supreme Court.

## CHAPTER 9

# Re-inventing Pakistan: Islam, Security and Democracy—What is Changing?

SAEED SHAFQAT

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**T**his essay analyzes the changing dynamics of Islam, the military and democracy. I will argue that the composition and support base of the religious parties, the military and the elected public officials has undergone a transformation, and that new coalitions are emerging which are changing the face of Pakistani politics and society. The religious parties, the military and the elected public officials are preoccupied with considerations of power and state security rather than economic reform. The predicament for the military and the Musharraf-Jamali regime is how to reconcile the security imperatives of the state with democratic expectations of its citizens. The new alliances and coalitions that the military has built to chart the course of democratic process in Pakistan do not breed much confidence among Pakistan-watchers. Why?

In post-9/11 Pakistan, General Musharraf is faced with challenges similar to the civilian government of Zulfikar Ali Bhutto (1971-77) in 1972—namely, how to ensure the security of the state, deal with the resurgent religious right and build democratic processes? Bhutto softened confrontation with India and built a framework of peace through the

Simla Agreement (July 1972). He refurbished the alliance with the United States and sought accommodation with the religious right. The challenge then and now is how to reinvent and redefine Pakistan. Bhutto-Musharraf speeches on “enlightened moderation” and on Islamic political discourse evoke interesting comparisons; Bhutto in the 1970s and Musharraf now have roused expectations about a liberal, progressive, forward-looking and “moderate Muslim” Pakistan, but both did little in building coalitions with the liberal socio-political forces and sought appeasement and accommodation with the religious right. This is the paradox of liberal/modernist leadership in Pakistan.

I will argue two basic propositions. First, on the rise of the Muttahida-Majlis-e-Amala (MMA), most of the analysts argue that the military regime manipulated its rise. They argue that the military-mullah connection has been pivotal in facilitating the rise of the religious groups. The military-mullah argument, weighty and persuasive as it may be, overlooks an important fact—the disarray of liberal social-political forces represented by the PPP, PML (N) and ANP. Not only did these parties fail to make meaningful coalitions, they also disintegrated into factions. Despite a popular appeal and support base these parties could neither develop a coherent program nor an alternate coalition strategy. Second, the role of the military and composition of top military brass have undergone a transformation. The army has gradually moved away from the Huntingtonian model of professionalism confined to state security and primacy of civilian control to a Janowitzian model of “constabulary military” where interstate wars have been rare but cross-border insurgency and internal law enforcement have become the military’s key function. In most scholarly studies, the political role of the Pakistani military has been a primary focus of analysis. Its peacekeeping, intelligence and counter-intelligence roles have not received adequate attention. I will provide some conjectural evidence and analysis on how these roles may have transformed the outlook of its officer corps.

I will argue that in the past three decades, a generation of military elites has emerged whose war experience is not that of “war between states” but a world view that was deeply shaped by the “new wars” organizing, supporting, training, equipping paramilitary groups (Afghan Jihad) and simultaneously combating/monitoring other paramilitary groups (peace missions—Haiti, Somalia, Cambodia, Bosnia, etc.). The military elites who



came to dominate the decision-making power structure appeared enormously confident and convinced that for governance, political control and reform, they need not depend on the civil bureaucracy. Rather they must establish the military's hegemony.

## **SECURITY AND GOVERNANCE: AN OVERVIEW, 1972-2004**

How are religion and security intertwined and what impact has this had on governance? War, conflict and perceptions about regional insecurity could bring religious zealots and the military together. Pakistan makes an interesting case study. In the 1970 elections, the defeat of the religious political parties was followed by the defeat and dismemberment of Pakistan. However, in the “new” Pakistan, neither the role of the military nor that of the religious political parties diminished. Both remained a potent force. The religious groups were in disarray, but they had a clear goal—to maximize their power. To attain this they demanded the Islamization of laws and succeeded in securing more Islamic clauses in the 1973 constitution than in any previous constitution of Pakistan. In a constitutional/legal sense it was a major victory, but in the parliament and general power structure, the religious groups remained on the periphery. The constitutional changes gave a sense of confidence, legitimized their role and enhanced their power. The religious-political parties won on the Islamization of the constitutional provisions but their broad thrust has been restricting personal freedoms, subordination of women and minorities and enhancing the role of ulema in the Pakistani power structure.

The coming into power of the PPP under the leadership of Zulfikar Ali Bhutto (1971-77) as the prime minister of Pakistan was a frustrating experience for the religious right, particularly the Jamaat-e-Islami (JI). It was also an unwelcome outcome for the military. The two had fostered a partnership during the military regime of General Yahya Khan (1969-71). The dismemberment of Pakistan shook the very foundations of this partnership. It was a watershed event in Pakistani history. Both accepted the authority of the PPP government reluctantly and grudgingly. While Bhutto was swift in purging the army top brass and after appointing General Tikka Khan as chief of army staff (COAS) in March 1972, he felt secure and comfortable but his control over the military remained precarious.

The religious right was vociferous in attacking the Bhutto government as “un-Islamic” and demanded enforcement of the *Shariah* laws. Bhutto responded by a twin policy of appeasement and coercion. For example, while adopting the 1973 constitution he showed flexibility in incorporating the Islamic clauses, yet, he resorted to coercive measures and suspended the publication of a number of pro-Jamaat newsweeklies and papers. Despite appeasement and coercion, Bhutto could not completely subdue the religious right, which remained a potent oppositional force against the government. In early 1977, when the PPP government held elections but failed to demonstrate the fairness of these, the religious right provided the lead and banded together and formed the Pakistan National Alliance (PNA). The PNA demanded enforcement of *Shariah* laws and Bhutto conceded to many of these demands. Yet the religious right demanded his government’s resignation and incited the army to overthrow the PPP government. The confrontation between the PPP and PNA, street protests, loss of life and property encouraged the military takeover.

The military regime under General Zia ul-Haq rejuvenated the partnership between the religious right and the military. Besides, domestic factors and changes in the external regional environment—turmoil in Afghanistan, Islamic revolution in Iran and finally Soviet intervention in Afghanistan—galvanized the Islamic revivalist movement in Pakistan, facilitating the proliferation of Deeni Madarrassah (religious schools) and training camps. Now there is considerable evidence showing how the United States and Saudi Arabia funneled money, equipment and training to militant Islamic groups who were mobilized to wage a war against Soviet intervention in Afghanistan. These internal and external conditions led to the formation of a nexus between the militant Islamic groups and the military regime.

During the Zia era (1977–88), Pakistan’s involvement in the Afghan war deepened, while internally the regime launched a policy of the Islamization of laws, polity, economy and society in Pakistan. Supporting the Afghan war had implications for Pakistan. It not only had to accommodate more than 2 million Afghan refugees, but also harbor various international Islamic groups who were mobilized to wage and sustain Afghan Jihad. These holy warriors began to cultivate relations with Islamic groups who were small in size but deeply entrenched in Pakistan’s power structure. Thus Afghan Jihad and the Islamization of the Pakistani state grew simultaneously and supplemented each other.

With the signing of the Geneva Accords in 1988, the United States embarked on a policy of disengagement from Afghan Jihad. However, Pakistan's president Zia ul-Haq, who had vigorously supported the jihad, felt that the U.S. disengagement was premature and jeopardized the prospects of installing a government led by the Afghan Mujahideen. Zia had come to believe that the United States had reached an agreement with the Soviet Union and no longer needed Pakistan's support. Instead, by eliciting the support of the Prime Minister Mohammad Khan Junejo on the Geneva Accords, the United States was aiming to discredit the Pakistani military, which had successfully organized the Afghan resistance movement. Zia and his military associates who had engineered and sustained the Afghan war were completely left out of the Geneva Accords. The U.S. disengagement left the Pakistani military, the various Afghan factions and the religious groups to their own devices.

From 1988 to 1994, Afghanistan underwent a civil war as various factions struggled to establish their control over Kabul. The military and religious groups in Pakistan began to reposition themselves for the installation of a pro-Pakistan government in Kabul. Besides the Afghan civil war, another factor, the uprising in Indian-held Kashmir in 1989, contributed towards reinvigorating the partnership between the military and religious groups in Pakistan. Confident of success in the Afghan resistance, the military found it convenient to mobilize the religious groups to support the Kashmir uprising. They encouraged the religious groups to provide sanctuary, and training and built connections with the militant religious groups. During 1980s and 1990s, Pakistan witnessed the proliferation of militant religious groups. These groups, hardened in the Afghan war, built extraterritorial connections and indulged in transnational wars. The Afghanistan war and Kashmir uprising deepened the already stable connection between the military and the Jihadi groups in Pakistan.

In the wake of the infamous terrorist attacks on the World Trade Center, Pakistan was compelled to revise and reformulate its Afghan and Kashmir policies. After joining the international coalition against terrorism in October 2001, governance is no longer only an internal issue for Pakistan; it has acquired international overtones and salience. Pakistan embarked upon a policy of providing logistical support, use of air space and intelligence cooperation with the United States. This has given new meaning to governance, where the Federal Bureau of Investigation,

Central Intelligence Agency, and Special Services Group have launched programs of cooperation and training for Pakistani counterparts. The collaboration between Pakistan and U.S. on issues of governance and counter-terrorism has had two consequences: first, it strained and severed the linkages between the religious groups and the military, and second, it has evoked fierce resistance from the Jihadi groups and remnants of the Taliban. In the light of these circumstances, the challenge before the Musharraf military regime was how to redefine relations with the religious groups and the parameters of security.

### **COALITIONS OF RELIGIOUS PARTIES: WHY AND HOW?**

As noted above, in the last three decades, the politics of coalition-building and interest aggregation has replaced the politics of mass mobilization and mass agitation in Pakistan. This is best reflected in voter turnouts, political apathy, and decline or death of party workers (*jiala*) leading to the de-institutionalization of political parties. Ironically, political parties fragmented at a faster rate during 1985-99, as Pakistan made a transition to electoral democracy. During this period, domestic conditions and the external environment proved conducive for the religious political parties, which devised new methods to expand the political role of Islam in Pakistani society and culture. The religious political parties and groups expanded their support base among the trader-merchant classes in the Punjab, NWFP and Karachi.

The roots of recent successful coalition-building efforts by the religious political parties can be traced from the formation of the Pakistan National Alliance (PNA) in 1977—an alliance that comprised nine political parties and which was dominated by Jamaat-e-Islami (JI), Jamiat-ul-Ulema-Islam (JUI), and Jamiat-ul-Ulema-Pakistan (UP). The 1977 PNA movement against the Z.A. Bhutto government was a catalyst for strategizing the coalition politics of religious parties. During this movement, the Juma Prayers (Friday congregations) were used as an effective tool to mobilize the population; the *Masjid* (mosque) was transformed into a focal point of networking and mass mobilization. The *Masjid* began to be increasingly used as vanguard for political messages while madrassas developed into sanctuaries of religious indoctrination and training. From the PNA movement the religious parties learned that for instrumentalizing Islam, the

politicization of the mosque is essential. In the urban centers, Jamaat-e-Islami spearheaded the movement and built coalitions with the JUP and the JUI, which both had effective control over the mosques.

During 1979-89 the religious parties, particularly JI, collaborated with the military regime in the Afghan jihad. During the 1990s sectarian conflicts compelled the religious parties to address the problem. This led to the creation of another coalition dominated by the religious parties in March 1995—the Milli Yakjehati Council (MYC), a coalition of over 15 religious parties. However, the Council fell apart when JUI(F) and JUI(S) developed differences. It had limited success in curbing sectarian violence. During the 1997 elections the JI made an unsuccessful attempt to convert MYC into an electoral alliance. In 2000, led by JUI(F) 29 religious groups formed yet another coalition—Islamic Muttahida Mahaaz (IMAM). This was regional in character, focusing on NWFP and Baluchistan. IMAM was vociferously anti-American, attacked the NGO's particularly women's groups and indulged in destroying and disrupting satellite and cable networks in the NWP and Baluchistan.

Maulana Fazal-ur-Rehman JUI(F) at Peshawar organized the Deoband Conference in June 2000. The conference was attended by many scholars from a number of Muslim countries. Reportedly over a million people from all over Pakistan attended it. The MYC, IMAM, and Deoband Conference were precursors to the Pak-Afghan Defense Council (PADC) formed in October 2001—a coalition of 30 religious parties. Events subsequent to the World Trade Center attacks provided a rallying point for the religious parties to band together in opposition to actions taken by Musharraf and later by the United States. For a variety of reasons the PADC could not act in a unified manner or define a coherent agenda against the military regime. Ultimately, a trimmed-down PADC became the MMA election alliance (Qazi Hussain Ahmed claims it was formed at his residence in June 2002).

While participating in the October 2002 elections, the MMA demonstrated greater flexibility and pragmatism while making seat adjustments. It was skillful in cultivating an image among the voters that since it is a coalition of six Sunni and Shi'a religious parties its victory may curb sectarianism, and to a limited degree it did. In the one year after joining the ruling coalition at the national and provincial level, it has demonstrated that it aims to stay in power and is willing to make bargains and compromises.

## NEW SOCIAL GROUPS

These are groups, social classes and leaders who emerged during Zia's years and expanded their power base during the decade of the 1990s as Pakistan struggled with the consolidation of electoral democracy. These groups banded together for ideological, social, class and attitudinal reasons. These groups have generally opposed the politics of mass mobilization and shown preference for coalition-building and interest protection.

In collaboration with the military they found it prudent to pursue and protect the interests of their support groups through coalition formation—increasing reliance on Briadari (clan), tribal affiliations and religious right. The PML(Q) and MMA coalition needs to be seen in that context. My preliminary research on the outcome of the 2001 Local Bodies election and 2002 election results seems to suggest that the socio-economic and educational base of the elected representatives has undergone some change. The landowning groups and tribal leaders continue to dominate, but trader-merchant classes, business groups and middle class representation has marginally increased. More significant is the emergence of a younger generation of elected representatives from the old established political families. The introduction of an educational qualification clause has contributed to the rise of a small but new breed of elected public officials. Do changes in the socio-economic base and education promote liberal democratic values? The conduct, behavior and performance of parliamentary politics do not show a positive correlation.

## CHANGING COMPOSITION OF THE MILITARY AND BUREAUCRATIC ELITES

The generation of officers who have emerged as the decision makers in the post-1999 period entered service in early and mid-1960s. As young officers, they got the opportunity to participate in the September 1965 war. These officers were still in the formative phase of their careers when they saw another war. In a way, the top rank of the current military regime and officers were recruited into service between the two wars of 1965 and 1971. Most of the corps commanders are urban-based, educated in the colleges of Lahore, Peshawar, Rawalpindi, and Karachi. It must also be kept in view that the period between the two wars was a very turbulent period in the

history of Pakistan. Therefore, their worldview is shaped by the events and circumstances of that period. However, their professional advancement, operational skills and interaction with higher levels of security policy making formed during Zia regime. Most of the current corps commanders and staff officers were serving as majors and colonels, and the Zia years' deep involvement of Pakistan army in Afghanistan war had an enormous impact on the thinking, outlook, and orientation of the officers and ranks.

During these years, closer involvement in Afghan affairs, although confined to a limited number of officers but encompassing the overall involvement of the army, led to the merging of professional skills with motivational dimensions (Islamic ideology/the Jihad Syndrome). The Afghan war considerably diffused the pattern of martial, non-martial race generals. The pattern began to tilt towards an urban, "non-martial race" breed of officer, a change that has considerably diluted the dominance of the so-called "martial races" in the higher commands and could be regarded as a major transformation in the traditional composition and outlook of the army's high command. Evidently, the urban-based generals have shown greater pragmatism in making a transition from a professional role to a constabulary/managerial role. However, the worldview of these officers, particularly on issues related to security, appears to have been considerably influenced by the policies and legacies of the Zia years.

The regime has been more than enthusiastic in appointing military officers in top administrative positions. Over 800 hundred retired and serving officers above the rank of brigadiers have been appointed to various senior civil administration positions. There are three methods through which military officers are inducted into civilian positions. First, serving officers are given prize posts in government corporations and semi-autonomous organizations (PIA, WAPDA, NSC, vice chancellors, think tanks). Second, retired officers are recommended by the service headquarters for re-employment. Third, since 1980, through induction each year, 6-11 officers are recruited in three elite CSS services—the DMG, Police and Foreign Service. In addition, in the lower level government jobs (grade 1-15), retired ex-servicemen are given jobs.

The social class, educational background, professional experience and ideological orientation of the military top brass have also been undergoing changes. First, the Afghan war expanded the Pakistan military's intelligence and insurgency/counter insurgency role and experience. This

resulted in deepening its already well-entrenched position in domestic politics as “policeman.” Second, the collapse of the Soviet Union provided yet another opportunity to enhance the peacekeeping role and functions of Pakistan military. It is recognized as the largest UN peacekeeping military in the UN operations. The UN peacekeeping exposure established the professional reputation of its soldiers and officer corps. Third, lack of trust and absence of consensus among the political parties and allegations of corruption during civilian rule between 1988-99 tarnished the image and functioning of political parties. All these developments led to the expansion of a “policing” role of the military.

The overstretch in the policing functions of the military has eroded the credibility of the military as an institution. In 1997, a survey was sponsored by the United States Information Agency through a consultancy firm to evaluate the public confidence in different institutions—judiciary, bureaucracy, political parties, military. Not too surprisingly over 80 percent of the respondents held the military in the highest esteem and considered it the most credible institution. However, if a survey were conducted today to measure the credibility of the military in the public eye, it would certainly be low, if not totally disappointing. Media reports of job grabbing and financial corruption by the military have considerably tarnished its image and reputation in the public eye.

The composition of the higher bureaucracy (the Civil Services of Pakistan) has undergone considerable transformation. Four unrelated developments are changing the character and composition of higher civil service in Pakistan. First, the Local Bodies Plan 2001 and its implementation; second, foreign training opportunities; third, the UN peacekeeping and policing postings in Balkans, Sierra Leone, East Timor, etc; fourth, NGOs have provided consultancy opportunities to the civil servants, encouraging many to take temporary leave and deputation from the service. The District Management Group (DMG) has been adversely affected by the Local Bodies 2001 Plan. Its prestige, power and glory has been undermined by the dissolution of the office of the Deputy Commissioner–district as the lynchpin of administration. After initial dismay and resistance, the DMG officers have found alternate ways to enhance their professional skills and restore lost power by seeking foreign scholarships and training abroad. The trend had begun in the early 1990s, when the British government expanded the Cheavening training program for Civil Services and professionals in



Pakistan. Since 1996 on an average 25–30 officers under the age of 40 have acquired some kind of training—resulting in a segment of civil servants better educated and professionally qualified but not necessarily satisfied with work conditions and the environment. In the post-2001 period, the expansion of Humphrey Hayes and the revival of USAID and other programs have provided fresh opportunities of training to the higher civil services. The IMF-sponsored PIFFERA project with the Central Board of Revenue (CBR) has been functioning for some years. For example, in 2003, 25 officers from grade 18–20 received short-term training in Canada.

The foregoing analysis of the changing composition of the military-bureaucratic elites and elected public officials and the ascendancy of the religious parties demonstrates that the dynamics of politics are undergoing transformation. However the dynamics of these changes are not necessarily facilitating a balanced institutional development, thus constricting the prospects of democratic governance. The future of democracy and consolidation of democratic institutions in the country hinges on the disengagement of the military from civil sectors, revival, sustenance and restoring the legitimacy of mainstream political parties, and professionalization of the civil service.

## CONFERENCE AGENDA

9:00

### WELCOMING COMMENTS

**Robert M. Hathaway**, director, Asia Program,  
Woodrow Wilson International Center for Scholars

9:10-11:00

### PANEL I: PAKISTAN AND AN ISLAMIC ECONOMY—THE PRIVATE SECTOR

*Islamization of Economy—Pakistani Experiences*

**Khurshid Ahmad**, Institute of Policy Studies, Islamabad

*Islamization and Private Enterprise: Can the Two Work  
Together?*

**Shahid Javed Burki**, EMP Financial Advisors

*The Impact of Islamization on Women*

**Isobel Coleman**, Council on Foreign Relations

**Moderator: Munawar Z. Noorani**, chairman,  
Fellowship Fund for Pakistan

11:15-1:00

### PANEL II: PAKISTAN AND AN ISLAMIC ECONOMY—INSTITUTIONS AND THE GOVERNMENTAL SECTOR

*Riba and the Superior Courts*

**Charles Kennedy**, Wake Forest University

*Islamization, the State and Development*

**Vali Nasr**, The Naval Postgraduate School, Monterey

Conference Agenda

*The Profit Motive in Islam—Which Types of Institutions  
Can Support or Hinder Markets?*

**Omar Noman**

**Moderator: William B. Milam**, senior policy scholar,  
Woodrow Wilson Center

**1:00–2:45**      **LUNCH**

**Luncheon Address:** *Islamization and the Pakistan  
Economy*

**Ishrat Husain**, governor, State Bank of Pakistan

**3:00–4:45**      **PANEL III: THE POLITICAL AND SOCIAL  
DIMENSIONS OF AN ISLAMIC ECONOMY**

*Poverty and Social Justice: Some Challenges for Islamization  
in Pakistan*

**Parvez Hasan**, World Bank

*Reinventing Pakistan: Islam, Security and Democracy—  
What is Changing?*

**Saeed Shafqat**, Columbia University

**Moderator: Dennis Kux**, senior policy scholar,  
Woodrow Wilson Center

**4:45–5:00**      **CONCLUDING THOUGHTS**

**Akbar Ahmed**, American University

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