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# Property Rights, Institutions and Economic Development: An Islamic Perspective

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## Introduction

The evolution of property right institutions and their consequence on investment decisions are central issues in the political economy of development. Effective and well-defined property rights are deemed essential in providing the preconditions for economic growth. The importance of property right arrangements stems from the fact that they impact and alter the distribution of income. Economists are, therefore, in agreement that market transactions are more efficient when property rights are enforced.<sup>1</sup> According to North and Thomas (1973), observed variations in economic performance across countries were related to the presence (or absence, for that matter) of property right institutions. Recently, Besley (1995), and Feder and Feeny (1991), have argued that economic development and well-established property right institutions are positively correlated. Meanwhile, there are two arguments in the literature in favour of establishing property rights institutions. First, assigning ownership of valuable assets and designating the parties bearing the rewards and costs is expected to strengthen market forces. In particular, the private control over assets and the ability to reap the rewards from exploiting these assets create incentives for investment and production. Second, enforcing contractual agreements is expected to provide economic agents with the incentives to use resources effectively and efficiently. When property rights are poorly defined, contracts become hard to enforce and fraud and corruption go unpunished. Bureaucrats responsible for formulating government policies will use their positions to influence the allocation of resources whereby, business managers find themselves forced to buy favours.<sup>2</sup> The need to pay substantial bribes will, therefore, reduce the entrepreneur's incentives to invest and impose a significant burden on economic growth. Empirical evidence based on cross-country comparisons does indeed suggest that corruption has large, adverse effects on private investment and economic growth. Mauro (1996) showed that when a country improves its standing on the corruption index, say, from 6 to 8 (0 being the most corrupt, 10 the least) it will experience a 4 percentage point increase in its investment rate and a 0.5 percentage point increase in its annual per capita GDP growth rate. These large effects suggest that policies that establish institutions to curb corruption could have significant payoffs. Political corruption will also undercut the government's ability to raise revenues from issuing licenses and permits, and lead to ever-higher tax rates being levied on fewer and fewer taxpayers. This, in turn, reduces the government's ability to provide essential public goods, including the rule of law.<sup>3</sup> When institutions are weak, bribes can alter outcomes of the legal and regulatory process by inducing the government either to fail to stop illegal activities (such as drug dealing or pollution) or unduly favour one party over another in court cases or other legal proceedings. Furthermore, theoretical and empirical studies have shown that corruption and political control usually raise transaction costs, uncertainty, and are associated with free-rider problems. These costs will, therefore, constitute a dead-weight loss to the society. Unless political and economic reforms are made, these inefficiencies will certainly hamper growth and development.

Although there is a well-established body of theoretical knowledge on the benefits of establishing property rights institutions, there are several questions needed to be answered. For example, since the economic benefits of property rights are so large, why do not governments enforce them? The fact of the matter is, establishing property right institutions (e.g. criminal and civil justice systems, high-profile government watchdog agencies, etc.) is costly to the society since it is financed by general taxation (De Meza and Gould, 1992). Private enforcement is also costly because property owners have to incur significant costs to protect their rights. Hence, the decision to enforce property rights requires balancing the costs and benefits of enforcement. Moreover, establishing property right institutions requires political stability. A stable and reform-minded government would further the country's broader interests by establishing property rights institutions. On the other hand, the instability of the political system impedes the coordinating power of the market and infringe property rights.<sup>4</sup> The post-cold war move to a more integrated world economy has made property rights institutions particularly important. Countries are continuously competing for foreign direct investment (FDI) and portfolio investment while foreign investors are attracted by stability, predictability, and honesty in government (Klitgaard, 1998).

## I.

One of the most interesting and widespread developments in the Islamic world in the last two decades appeared in the field of Islamic law and finance. The outgrowth of modern banking on the basis of the *Shari'ah* (Islamic law) renewed an old debate on the relevance of an old model to contemporary economies. What makes this development interesting is the fact that the Islamic economic and financial practices are not bound primarily by the marketplace. It is the *Fiqeh*, jurisprudence, and the *Shari'ah* in general, that form the background against which all attempts in finance and business find guidance and legitimacy. Since the Islamic law gives any financial practice its legitimacy and significance, the reliance of Islamic finance on law is inevitable [Saleh, (1986)]. Consequently, considerable efforts have been devoted to the Islamic-banking model, explaining its principles, concepts, and viability in the context of Islamic law. Perhaps what remains to be told is that implementing the financial system of Islam is no longer a theoretical myth but an existing reality.

One issue that has received little attention in the current literature, despite its relevance and importance, is the issue of property rights in Islam. It is well known that effective and properly defined property rights are essential in providing the preconditions for economic growth. Islam acknowledges private ownership of assets insofar as this is in conformity with the Islamic law. Yet, the right of ownership is limited by certain considerations such as prohibition of usury and the legal obligation to give alms [Rodinson (1986)]. In fact, the Qur'an (the main source of Islamic Law) contains various dictates and prohibitions regulating ownership [Bashir (1998)]. The objective of this paper is to give an overview of the ownership rights in Islam, the acceptable means for acquiring wealth, and the Islamic restrictions on private and public property. Section II discusses the concept of ownership in Islam and its relationship to the concept of stewardship, a constituent of the Islamic faith. Section III discusses the source of ownership from an Islamic perspective. The obligations and restrictions placed by the *Shari'ah* (Islamic law) on ownership rights are discussed in Section IV, while the institutions required to enforce and protect property rights are discussed in Section V. Section VI focuses on the impact of institutions on economic development, and Section VII concludes the study.

## II. Property Rights in Islam

Ownership rights in Islam originate from the concept of *khilafah* (stewardship) which is a constituent of the Islamic faith. Generally speaking, ownership is regarded as depending less upon the independent activity of men than upon God's will (Rodinson, 1978). That is, God's ultimate ownership of property supersedes that of the individual. The *Qur'an*, the major source of Islamic Law, clearly and explicitly stated that *Allah* (God) is the sole owner of wealth and that people, as vicegerents of God, are merely trustees or custodians.<sup>5</sup> Yet the individual claims to *al-mal* (which denotes all the resources made subservient to man) are recognised and safeguarded by law.<sup>6</sup> In practice, nothing prevents the Muslim owner of private property from quite legitimately causing his property to fructify in the capitalist manner. It is true, of course, the use of whatever is owned is restricted by the prohibition of *riba* (usury) and the legal obligation to give *zakat* (alms). The *Qur'an* (57:7) explicitly states: "Believe in Allah and His messenger, and spend of what whereof He made you trustee." Therefore, man's ownership of *al-mal* is understood to be a trust, and that spending it is a test of faith. The *Qur'an* [6:165] states: "It is He who hath made you (His) vicegerents (or stewards), inheritors of the earth. He hath raised you in ranks, some above others; that He may try you in the gifts he hath given you." Therefore, a person entrusted with wealth can achieve the highest degree of virtue (*Falah*) by spending out of his wealth within the boundaries prescribed by the Shari'ah [Qur'an (2:261)].

Meanwhile, since the objectives of the Shari'ah pertain to this world and to the life *Hereafter*, it is no surprise that the concept of stewardship brings the idea of accountability. Accountability indicates that we can neither evade the responsibilities for our actions, nor the motives behind them. Therefore, the repercussion of every human action is two-fold: its effect in this life "this worldliness" and its effect in the life *Hereafter* "other worldliness." Kuran (1989) states: "In the terminology of modern economics, he is to bring into his calculus the negative and the positive externalities of his actions." Most important, the belief in the *Hereafter*, which extends the life horizon beyond physical death, elicits an intertemporal behaviour (Bashir, 1998). In addition, the pattern of eternal reward and punishment exemplified in the *Qur'an* motivates compliance with the dictates and prohibitions of the *Shari'ah* (the sacred law of Islam). For example, when someone decides to pursue a business venture, he must take into consideration not only his expected profits (the worldly benefits) but also the eternal rewards he might get from benefiting the community. Perhaps the most indispensable goal of the *Shari'ah* is realising the economic wellbeing of the society through full and efficient utilisation of resources. Al-Ghazali, a great Islamic jurist wrote: "The very objective of the *Shari'ah* is to promote the welfare of the people which lies on safeguarding their faith, their life, their intellect, their posterity and their property. Whatever ensures the safeguard of these five serves the public interest and is desirable."<sup>7</sup>

In the meantime, the *Shari'ah* explicitly specifies a set of rules and principles that regulate the legitimate sources of acquiring *al-mal* (property), its growth and its disposal. These moral limits are meant to achieve two vital objectives: restoring *Adl* (socio-economic justice) and promoting *Ihsan* (mutual benevolence) [Qur'an, 16:90]. *Adl* and *Ihsan* in Islam are meant to articulate the notion that people should have equal opportunities, not necessarily equal riches.<sup>8</sup> By emphasising *Adl*, the *Shari'ah* intends to eliminate all forms of economic inequality, injustice, exploitation, oppression or wrongdoing, whereby a person either deprives others of their rights, or does not fulfil his obligations towards them. The principle of *Adl* forbids gross inequalities in the distribution of goods

and indicates that the ownership of wealth has social as well as economic dimensions.<sup>9</sup> In the same vein, the principle of *Ihsan* is a reassurance that *al-mal* is to be used to maximise the welfare of the community (*Ummah*). While restoring *Adl* is a necessary condition, *Ihsan* is a sufficient condition for equitable distribution of income.

Among the many injunctions placed by the Shari'ah is the condemnation of wasteful and extravagance spending [Qur'an (17:27)]. Extravagence (*Israf*) is prohibited because it violates the principle of equality and because it entails consumption beyond the average level for society (Kuran, 1989). People are therefore encouraged to be modest and to utilise the available resources in ways that fulfil their needs and improve their lives. Yet the resources have to be used in accordance with God's revealed wisdom to attain the objectives of the Shari'ah, whether mundane or spiritual. Another important injunction is the proscription of hoarding (*kantz*). In today's economic thinking, hoarding can be harmful because it limits the productive capacity of the resources and disrupts the redistribution of wealth. Chapra (1985) states: "Islam provides an economic system that makes it absolutely imperative to use God-given resources for fulfilling the essential needs of all human beings and providing them with decent living conditions."

### III. Sources of Private Ownership

The Islamic (Shari'ah) law clearly and explicitly specifies the rights to own, use and dispose of property. The Islamic concept of property rights commensurate with work effort. Work effort, in all its forms, is considered to be a perfectly legitimate means to own property, insofar as this is in conformity with the moral requisites. There are numerous injunctions urging the followers of Islam to engage in productive activities and pursue legitimate monetary gains to improve their economic well-being. For example, the Shari'ah dictates that it is a divine duty for everyone to work and use his abilities to gain a just reward from his/her work effort.<sup>10</sup> Consequently, the individual can acquire property, including the means of production, through a host of legitimate means acknowledged by the Shari'ah. Although the Islamic sources of private ownership were profoundly influenced by the circumstances of the earlier days of Islam, they are, nevertheless, still relevant and safeguarded by law.

#### *Farming*

Property can be acquired through developing and utilising arable fertile (farming) land, unclaimed by anyone.<sup>11</sup> According to the Islamic theory of landed property, the idea of development and fructification of what one possesses bind ownership. However, the right someone has acquired to a piece of land is not lost merely through non-use, it vanishes if someone else brings this land under cultivation.<sup>12</sup> The purpose of such law is to benefit the general public by bringing life to the virgin land and to ensure the continuity of utilisation.<sup>13</sup> The concept of sharecropping is acknowledged by most Islamic schools of thought as a justifiable mode of acquiring property rights.

#### *Mining*

Extraction of minerals (*al-rekaaz*) is another accepted source of claiming ownership rights.<sup>14</sup> Here the extractor is assured of fourth-fifth of the yield, provided that these minerals are extracted through individual efforts. The other fifth is claimed by the public treasury (*Bait al-mal*).

### *Inheritance and Bequest*

Islamic jurists agree that property rights can be transferred through inheritance and bequest. The Shari'ah has detailed sets of rules and regulations concerning the intergenerational transfer of asset ownership from parents to children. In principle, the ownership rights of the entire inherited wealth can go to one heir. However, only one third of the property can be willed away as a bequest.<sup>15</sup>

Another important source of ownership acknowledged by the Shari'ah is the right of *Ash-Shufe'ah* (pre-emption). The right of *Ash-Shufe'ah* gives the neighbour and/or the partner the right to acquire the property of his neighbour or partner when the latter intends to sell it. The Prophet was quoted as giving a verdict regarding *Shufe'ah* in every individual joint thing (property). But if the limits are defined and the shares are identified, there is no pre-emption. *Waqf* is also a legitimate means of acquiring the benefits of ownership.<sup>16</sup>

### *Trade and Commerce*

Ownership rights can also be acquired through trade, commerce, and contracting. It is important to note that what is forbidden by the Shari'ah is the fixed or predetermined return on financial transactions (interest) and not the uncertain rate of return represented by profits. The Qur'an (2:275) states that trade is permitted and usury is forbidden. Economic activity, the search for profit, and consequently, production for the market, are looked upon favourably. All types of contracts, such as *Ijara*, *Musharaka* and *Mudaraba*, are permitted so long as the ethics of contracting are observed. Faithfulness to contractual obligations is by all means an important clause in the Islamic (Shari'ah) law.<sup>17</sup> It is noteworthy to mention here that, no specific wording is recommended as *the* way to make contracts. Any consensual transaction between two trading partners is considered a binding contractual agreement. However, the contracting parties should have perfect knowledge of the countervalues intended to be exchanged as a result of their transaction (Saleh, 1988). This freedom of contracting provides the parties with the flexibility of virtually making open-ended menu of financial transactions and instruments [Khan and Mirakhor (1987)].

### *Physical and Mental Work*

Since Islam seeks to promote the economic well-being of man within the framework of its moral norms, it urges man to engage in productive activity. Wage-labour is seen as something perfectly normal. The Qur'an (9:105) stated: "And say: work; soon will Allah observe your work and His Apostle, and the Believers." This high admiration for work is a clear invitation to innovation and perfection. If the job is done with care and devotion, ownership is considered a fair return.

### *Public Ownership in Islam*

Islam envisages a variety of property rights that accrue to the State. The State, in the Islamic system is a form of collectivity whereas it derives its authority from the concept of *Khalifa* (vicegerency). Bound by the moral teachings of Islam, the State has a number of duties to perform that are derived directly from the Qur'an and the Sunnah. These include activities such as defending the territorial integrity of the state; maintaining law and order; propagation of good and suppression of evil; assurance of at least a basic mini-

imum standard of living for all its citizens, and prevention of gross inequalities in income and wealth distribution. The State was supposed to generate sufficient funds to carry its obligations.

In the early Islamic period, expropriations 'for the public good' were numerous whereas, immense areas of cultivable land was placed at the disposal of the State. It was indispensable that this land be exploited so as to meet the costs of the machinery of State. The revenues generated from public property were used to provide help for the needy and the poor, and to finance the functions of the State. Public property was also expropriated for public utility pasturage, mining, water sources, and the farming land designated to generate revenues for the treasury (*Bait-ul-mal*). Although the Shari'ah advocated sharing rather than excluding, nevertheless, it restricts and regulates public ownership.<sup>18</sup> For example, the designated public farming land can not be used for private purposes unless a certain arrangement is made (e.g. share cropping).

It was quite true that in the early stages of the Islamic State, revenues came mainly from agricultural production. However, other sources of public revenue also existed. These included *zakat* (poor due to be recovered from Muslims), *kharaj* (land tax on agricultural land surrendered to Muslims without any resistance), *jizyah* (poll tax on non-Muslims residing in Muslim territories), *ushoor* (custom duties) and *rekaaz* (mines and treasure-trove). *Ghanimah* (spoils of war), and *fai'* (booty surrendered by the enemy without actual fighting), are other occasional sources. Each one of these sources was subject to a separate fund account, and was distributed according to certain sets of rules. For instance, *Diwan al-Zakat*, with its dual role of collecting and distributing the Zakat, and *diwan al-Kharaj*, for collecting taxes, were examples of public institutions for administering public revenues. Public property also included religious institutions, public endowments (*awqaf*), and the natural resources buried underneath the earth.

Meanwhile, since the generated public revenues should be spent to finance public projects that benefit the general public, the State (government) is expected to seek other ways to generate enough revenues to carry its civic and defense expenses. In fact, the Shari'ah had provided broad guidance for the state to perform its functions. The permissibility of dynamic interpretations (*ijtihad*) can be exploited to find solutions to newly emerging problems. Applying the principles of *qiyas* (analogical deduction) and *al-masalih-al-mursalah* (judgement based on public welfare), jurists have concluded that the State should be active in promoting overall economic activity by full utilisation of productive resources.

#### IV. The Shari'ah Restrictions on Property Rights

Ownership and acquisition in Islam are restricted and limited by numerous obligations laid down by the Shari'ah to render them absolutely harmless. These restrictions comprise a set of moral and religious principles and doctrines that guide and regulate ownership in Islam. From an economic perspective, one would expect these restrictions to enhance economic performance by restoring both equity and efficiency. Nonetheless, since the Islamic economic regulations are closely related to moral standards, submission to these regulations emanates from one's conscience. Hence, the following restrictions have to be taken as axiomatic.

***Prohibition of Usury (Riba):***

The central restriction of the Islamic economic system is the prohibition of *riba* (interest) in all financial transactions. According to the Islamic value system, *riba* represents a prominent source of unjustified advantage and those who deal with *riba* are waging war against Allah and His Apostle [Qur'an, 2:279]. Indeed, the Shari'ah has acknowledged the usage of the unspecified rate of return (profit) as a mechanism for allocating resources. The Qur'an (2:275) state: "*But God hath permitted trade and forbidden usury.*" A system based on profit and risk sharing is believed to be more equitable than a system based on interest and usury.

***Prevention of gharar (chance):***

Starting from the notion of protecting the weak against exploitation, the Shari'ah has prohibited any transaction entailing uncertainty, speculation or risk (*gharar*). The Shari'ah prohibited any gain that may result from chance, and from undetermined causes. A certain game of chance that received an enormous degree of prohibition is *maysir*. Above all, what is prohibited is any selling in which there is an element of uncertainty (see Rodinson, 1978). If the subject matter of the contract is not existent or even present at the time of contracting, the transaction was regarded void.

***Repudiation of Monopoly:***

There is a general principle in Islam that wealth should not be monopolised in the hands of a few individuals, since this will create social imbalance. The Shari'ah prohibits monopoly and exclusive possession of al-mal because monopoly, and interest, are believed to be the primary vehicles of financial exploitation and wealth concentration. By denouncing monopoly, the Shari'ah obliges that al-mal should be distributed in a way that does not confine it to a few wealthy people in the society.<sup>19</sup> Therefore, the private owner should adhere to the requirements of the Shari'a when acquiring, disposing, spending, transferring, or exchanging property.<sup>20</sup> The Qur'an (57:7) states: "And spend (in charity) out of the (substance) whereof He has made you Heirs."

***Prohibition of Unjustified Means:***

Any property acquired through unjustifiable means, like *gharar* (speculation), *maysar* (gambling), bribing, stealing, cheating, or illegal trading, is proscribed and forbidden.<sup>21</sup> Certain commercial practices are, however, prohibited (*Haram*) by the Shari'ah. These include the production and marketing of intoxicants, hoarding and cornering of stocks with the intention of creating artificial scarcity and profiteering. Interest-based transactions, bribery, theft, robbery, breach of trust and the use of fraudulent weights and measures do not satisfy the definition of al-mal, and therefore, are not worthy of ownership. Any contract involving these products is not binding and, hence, should not be honoured or enforced.

***Legal Obligation of Zakat (alms):***

Zakat occupies a unique position in the Islamic economic system. Meanwhile, the Shari'ah assigns to the State a clear-cut duty to organise a system of zakat collection and disbursement. The Qur'an (9:103) says: "Take alms of their wealth, wherewith thou mayst purify them and mayst make them grow..." According to the Islamic teachings,



payment of zakat purifies one's soul and leads to increase in material welfare in this world and growth of religious merit in the next. Those who fail to discharge this obligation are warned severe chastisement in the hereafter. Therefore, the property owner is deemed responsible for the payment of zakat when al-mal reaches the necessary limit of *al-nisab* (the minimum quantity of an asset which makes it liable to zakat) and is being in his ownership and possession for one full year.<sup>22</sup>

### ***Voluntary Spending for Welfare of the Poor (sadaqa):***

It is the general philosophy of Islam that human beings should be properly motivated to do the right things by themselves so that the coercive powers of the State are used for the minimum extent necessary (Ahmad, 1989). In the matter of income distribution particularly, Islam emphasises the virtue of *Infaq*, that is, voluntary spending for the welfare of the poor. The Qur'an (3:92) proclaims that in no case will man attain piety unless he spends freely from his wealth in the way of God for the needy and the poor. The repeated exhortations in this respect in the Qur'an and the *Sumnah* (the traditions of the Prophet) are meant to promote a culture and a way of living where people care for each other, and where the disparities in income and wealth are minimised.

### ***Efficient Use of the Property:***

By condemning hoarding and extravagance spending, the Shari'ah encourages and promotes efficient use of property. The owner is required to use his wealth in ways that benefit him while not hurting the general interest of the society. Any inefficient use of the property is considered spurious since it contradicts with the objectives (*Maqasid*) of the Shari'ah.<sup>23</sup> If the property owner proves his inability to use al-mal properly, he forfeits his ownership rights. Under such conditions, the community (State) is fully justified in withdrawing the rights of usage of that property<sup>24</sup> in order to protect it from the misuses of its owner. Imam Al-Shafe'i (a renowned jurist) is of the opinion that when someone goes beyond the point of moderation in expenditure, even if he/she is spending on good and lawful things, his/her property should be placed under the custody of the State.<sup>26</sup> This is because Islam attaches great importance to protecting people from harm. The Prophet is reported to have said "to cause harm to others is not allowed in Islam."

### ***Necessary Interests:***

According to the Islamic jurists, there are five necessary (*daruri*) interests needed to be fulfilled. These comprise the *deen* (religion), the *nafs* (life or self), *nasl* (family or progeny), *mal* (property), and *aql* (intellect or reason). One major liability of the property owner is to fulfill his *daruri* (necessity) obligations, since these obligations constitute basic religious duties on par with the annual payment of zakat.<sup>27</sup> The Qur'an (2:177) says: "It is not righteousness that ye turn your faces to the east and the west; but righteousness is to believe in Allah and the Last Day and the Angels and the Scripture and the Prophets; and spend of your substance, out of love of Him, for your kin, for orphans, for the needy, for the wayfarer, for those who ask, and for the ransom of slaves, to be steadfast in prayer, and practice regular charity; to fulfill the contracts."

### ***Investment of Al-mal:***

It has been argued that the Islamic prohibition of hoarding wealth entails continuous investment of al-mal in legitimate (*Halal*) enterprises. The Shari'ah encourages Muslims to

invest their funds sensibly, and neither gamble them away, nor otherwise waste them [Qur'an, 6:41]. Given the absence of interest, it can be seen that uninvested money will be entirely eaten up by the zakat over time. Hence the zakat is expected to have a stimulating effect on investment. Both the wealth (property) owner and the state are obliged to devise permissible investing techniques to reproduce al-mal.

## V. Property Right Institutions

The starting point for enforcing property rights begins by establishing legal as well as economic institutions. This is important because legal and economic institutions are inextricably linked and complementary to each other. Certainly, the preparation of written laws delineating individual's rights and responsibilities will compel participants to abide by these laws. On the other hand, the lack of a well-defined legal system specifying the domain and limitations of property rights would undermine any efforts to enter into long-term contracts. Not only does the Shari'ah acknowledge ownership rights, but also requires establishing institutions that will regulate, codify, and enforce property rights. Indeed, the Islamic system already has built-in institutional infrastructure to enforce and protect people's rights.

### *The Legal Institutions:*

In the Islamic legal system, there exist comprehensive clauses specifying the rights and responsibilities of property owners. Several times the Qur'an makes explicit reference to institutional authority to uphold justice, collect the zakat, or oversee the contractual agreements. In fact, the Shari'ah places a great emphasis on contracts, and the Qur'an (4:1) documenting and recording debts to protect people's right, the Qur'an says: "O ye who believe, when you contract a debt for a determined period, record it in writing and let a scribe justly record it in writing." Implementing and enforcing the Islamic law of contract is, therefore, expected to accomplish two things. First, it will foster compliance to long run contractual agreements. Second, the existence of monitoring institutions and/or written provisions will minimise the moral hazard problem associated with long term agreements. Hence, applying the Shari'ah is both a necessary and sufficient condition for initiating property rights institutions.<sup>28</sup>

Historically, the Islamic legal institutions used to protect property rights include the *Fiqh* (jurisprudence) institutions, the judiciary system, the *Shura* (consultation) institutions, and the *Hisbah*.<sup>29</sup> To ensure their integrity, these institutions were given total independence from the government (State). Under an independent judiciary system, the court system will be effective in enforcing contractual agreements, settling disputes, and specifying punishments. The strict and harsh punishments prescribed by the Shari'ah for violating property rights (e.g. stealing, burglarising, and using force to confiscate) would safeguard properties of all individuals. Moreover, the independence of the *Fiqh* institutions will allow the Islamic jurists to freely interpret relevant and applicable Shari'ah rules and perform *ijtihad*.<sup>30</sup> The *Shura* institutions, on the other hand, are needed to legislate regulations and secure compliance and accountability. Meanwhile, the State is expected to give due regard to *Shurah* and *ijma* (consensus of jurists) in formulating its policies in various spheres (Ahmad, 1989). Furthermore, the institution of *al-Hisbah* is meant to monitor the behavior of market participants, set the standards and be a catalyst for fostering ethical and honest behaviour.

### *The Market Institutions:*

Other indispensable institutions acknowledged by the Shari'ah to protect owners' rights include market institutions. In endorsing economic freedom and allowing maximum scope to market forces, the Shari'ah acknowledges price determination in commodity markets. However, it prescribes specific norms of behaviour to be observed by all participants in the market so that genuine interests of all parties are safeguarded (Ahmad, 1989). In fact, the Shari'ah specifies certain norms to enhance the market behaviour. For example, the parties entering any sale-purchase transaction have free consent (*Khiyar*) to reach an agreement. Once the transaction is completed, fulfillment of all terms of the contract is required. Islam also requires full access to the market by all buyers and sellers, correct disclosure about the quality of goods being offered for sale, non-interference with suppliers before entrance into the market, and use of correct weights and measures. On the other hand, adulteration, hoarding and cornering of stocks with the view of creating artificial scarcity and profiteering, collusion among buyers or sellers to hurt the interest of one party and bidding up of prices without the intention to purchase are severely condemned (Ahmad, 1989).

Historically, independent regulatory agencies like *al Hissbah*, *diwan al-azimmah*, *Real Estate Registry*, and the *Shari'ah committees in Islamic banks* were established to monitor trading practices and other fraudulent behaviours. The State was enjoined to institute arrangements for propagation of good and suppression of evil (*amr bil maruf wa-n-nahi anil munkar*). The Quran (22:41) says: "They are those who, if we establish them in the land, establish regular prayer and give regular charity, enjoin right and forbid wrong..." Moreover, Islam allows a considerable flexibility in using human reasoning to find solutions to new problems. The only constraint is that the objectives (*Maqasid*) of the Shari'ah should be met.

### *The Financial Institutions:*

The existence and widespread of credit and commerce in the Islamic world was attested at least three or four centuries before anything comparable is recorded in medieval Europe. Nonetheless, no formal institutions evolved into the kind of credit and banking institutions which were seminal in the economic growth of Europe (Udovitch, 1975). This is so despite the fact that many early Islamic legal writers assumed that credit dealings were indispensable to successful and profitable trading. Indeed, the contemporary banks and other financial institutions are encouraged insofar as they satisfy the Shari'ah injunctions (*Maqasid* of mobilising assets via various modes of profit-sharing arrangements. Surely the freedom of contracts allowed under the Islamic law provides the contracting parties with a flexibility that makes possible a virtually open-ended menu of various forms of financial transactions and instruments<sup>31</sup> (Khan and Mirakhor, 1989). Under the provisions of these profit-sharing arrangements, a good number of different types of trading companies (*Sharikat*) were known to Islamic jurisprudence (Gambling and Karim, 1985). According to the Islamic jurisprudence, the *Sharikat* can be of two kinds: *Sharikat al-milk* (non-contractual) and *Sharikat al-uqud* (contractual). The latter one is also divided into four categories: *Sharikat al Mufawadah*, *al-Inan*, *al-Abdan*, and *al-Wujuh* (Chapra, 1985). The equity-based system also entails innovation of new institutions, new markets and new instruments to eliminate the possibility of dealing with *riba*. For instance, largescale financial markets are needed to foster financial development. Yet

for many of these financial institutions, there exist clear and legitimate (Shari'ah) laws for regulating the financial system.

### ***The Monetary Institutions:***

In the monetary side, the avoidance of inflationary and deflationary pressures should be the top most priorities of the government in the Islamic State (Islahi, 1988). Recently some economists have suggested that the zakat could be used as a stabilising device to reduce inflationary pressures (Ahmad, 1983). Economic stabilisation is necessary because inflation and unemployment are believed to have serious consequences on property rights. While inflation reduces the value of the property and redistributes incomes unequally, unemployment entails lost output and income. Indeed, increasing the level of employment and reducing the level of inflation will restore equity and social justice. Hence, an active and independent monetary policy should be pursued to curb inflation. The monetary authority (central bank) should develop appropriate financial instruments that are permissible under Islamic law. Besides its role of regulating the banking system freely and diligently, the central bank should issue and control high-powered money. This requires the central bank to be an independent institution. An independent central bank will constrain the politicians from using the monetary system to achieve political goals. Recent evidence had shown that greater independence of the central bank is associated with lower inflation rates (Cukierman, 1992).

### ***The Political Institutions***

The above legal and market institutions should also be accompanied by political institutions. The institutions of *As-Shura* (mutual consultation) should be established. *As-Shura* is needed to reach consensus matters where there is no clear injunction from Qur'an and Sunnah. The *As-Shura* institutions could be formed to deal with legislative as well as executive matters. Al-Awa (1980) said: "It is more compatible with the Islamic method of legislation to leave matters to be brought before *As-Shura* unspecified and undefined, establishing only the principles and general rules, and leaving details to be worked out by Muslims in adapting the law of Islam to particular time and place." The institutions of *As-Shura* will implement the constitutional changes, safeguard the transition of power, and warrant political stability. The *As-Shura* institutions are also needed to regulate and protect ownership rights, to check the government performance, and enforce the rule of law.

## **VI. Institutions and Economic Development**

The objective of the Islamic perspective of development is to improve the social, cultural, economical and ethical condition of man (the vicegerent on earth) under the guiding principles of the Shari'ah. As Ahmad (1981) stated: "development would mean moral, spiritual and material development of the individual and society leading to maximum socio-economic welfare and the ultimate good of mankind." Hence, the legal, economic, and political institutions comprise the infrastructure needed to maintain sustained and balanced development. The impact of these institutions on growth and development can be analysed in terms of their effects on the distribution of income and wealth, resource allocation, saving and investment, and monetary stability.

The institution of zakat is expected to play an important role in income distribution and resource allocation. First, the zakat serves as a safety net for helping the poor and the

needy. The redistribution effect is expected to increase both aggregate demand and productivity. Second, the zakat is expected to have a strong stimulating effect on investment. By discouraging property owners from holding idle assets, the zakat will reduce the transaction demand for money. The stimulus effect of the zakat, together with the ban on interest, is expected to reduce the precautionary demand for money and increase investment. Finally, the redistribution effects of zakat are expected to have a positive impact on the level of aggregate savings.

The market institutions, especially Islamic banks, can make useful contributions to growth and development. Given the high degree of thrift practiced by farmers and peasants, expanding the interest-free banks in the rural areas will help transform the rural economies. The Islamic banks should use their profit and loss sharing schemes to finance productive sectors like agriculture and small-scale industries (micro credits schemes). Islamic banks can also make a significant contribution to growth and development, if they are able to attract foreign capital through cooperation and partnership (i.e. foreign direct investment). This could be the vehicle for transferring technology.

The monetary institutions will impact growth and development through price stability. It is well documented in the literature that managing the rate of growth of money can have a significant positive effect of economic growth. An independent central bank will manage the government financial transactions, issue and maintain the value of the currency, and sustain the public's confidence in the payment system. Moreover, as regulatory agency, the central bank can be a catalyst in guaranteeing transparency, accountability, disclosure and openness.

Meanwhile, the government in the Islamic State has an indispensable role to play in the economy. First, it should design policies that protect economic freedom and provide perfect information to the market. Second, it should target sustained and balanced growth, higher standard of living, and equitable distribution of income. Third, the government should also target the investment in human capital to increase productivity, the managerial ability of entrepreneurs, and acquire new knowledge. Finally, fiscal and monetary policy should be coordinated to attain economic stability and curb inflation.

## VII. Summary and Conclusion

The paper analyses the bearing of Islamic teachings on defining and enforcing property rights. It is strongly argued that the Islamic law (*Shari'ah*) acknowledges and specifically defines ownership rights. Not only that, but the Islamic law is explicit about the institutional framework needed to protect the rights and privileges of property owners. The paper further argues that Islam permits economic freedom and free market provided that these institutions do not violate the means of ownership. Meanwhile, the government in the Islamic State is expected to promote market-oriented policies to facilitate efficient allocation of resources.<sup>32</sup> However, the government is expected to keep its intervention in the market to a minimum, confined only to the enforcement of property rights. Hence, all economic and social institutions which improve income distribution, restore social justice and conform to the provision of the Shari'ah, should be established. The institution of *al-Hissbah* plays an important role in monitoring and enforcing the ethical and legal restrictions. Furthermore, it is argued that establishing these institutions will promote economic development. More research is needed in this area.

## Endnotes

1. Property rights are characterised as a bundle of exclusivity, inheritability, transferability, and enforcement mechanisms.
2. Corrupted bureaucrats will develop the habit of slowing paperwork until some kind of payment is made.
3. Based on cross-country comparisons, it seems that corruption alters the composition of government expenditure; specifically, corrupt governments spend less on education and perhaps health, and probably more on public investment. This result is a matter of concern because there is increasing evidence that educational attainment fosters economic growth. A vicious circle of increasing corruption and underground activities will result (see Gray and Kaufmann, 1998).
4. Empirical observation showed that, on average, countries that have malfunctioning property rights institutions tend to be more politically unstable. In that sense, the absence of property rights institutions and political instability may be two sides of the same coin.
5. See Qur'an (20:6).
6. The concept of Al-mal in Islam denotes all the resources which Allah made subservient to man on land, in the sea, as well as beneath the surface of earth. Al-mal is also defined as anything (property) that can be owned and has value, including the rights and benefits of ownership. It can be classified as *Halal* (justifiable) which is owned through legitimate means, or *Haram* (unlawful) which is acquired through unjustifiable means.
7. Al-Ghazali, *Al-Mustasfa*, Vol. 1, pp.130-140.
8. Justice and equity are such indispensable ingredients of the Islamic faith to the extent that it is inconceivable to think of an ideal Muslim society where these norms have not been actualised.
9. See Kuran (1989) for a similar argument.
10. The Qur'an (62:10) states: "And when the prayer is ended, then disperse in the land and seek of Allah's bounty, and remember Allah much, that ye may be successful."
11. The Prophet disapproved leaving productive assets (land) idle and urged those who own land to cultivate it or leave it to those who can do so.
12. The Prophet (PBUH) explained the principle of ownership of such land by saying: "Land belongs to Allah and the human beings too. Whoever rehabilitates barren land, becomes its owner." He also said: "There is no right of ownership to be claimed on the land if the owner does not reasonably exploit it after three years of possession."
13. During the decadence of the Roman Empire, the owners of agricultural domains were threatened with forfeiture of their property if they neglected to cultivate it (see Rodinson, 1978, pp.172).
14. Al-reikaaz are treasures buried during the pre-Islamic period. The extractor should declare it first before claiming its ownership. A similar practice was common during the

Roman Empire where a man was allowed to exploit a mine that he had discovered, regardless of whether the owner of the land gave his consent, and with only one-tenth of the product due to be paid to this owner, Rodinson (1978).

15. The Prophet (PBUH) told his companion Sa'ad, when he asked about the Will: "The third, and the third is too much."

16. Waqf is a public endowment where the benefactor has the right to reap the benefit from the asset but not the right of selling or exchanging it.

17. The Qur'an (2:275) says: "But God hath permitted trade and forbidden usury." While Qur'an (5:1) says: "O ye who believe! Fulfill (all) obligations."

18. Some kinds of primary product, such as water and grass, are no subject to appropriation. The right of ownership is also limited by certain considerations such as the right of everyone to life. A man dying of hunger is justified in taking the minimum of food he needs to keep him alive, at the expense of the legitimate owner, see Rodinson (1978, Ch.2).

19. Although people differ in their wealth, Islam always recommends equitable income distribution. Qur'an (59:7) states: "...in order that it may not (Merely) make a circuit between the wealthy among you."

20. There is a consensus among Muslim jurists that ownership cannot be established without the authorisation of the Shari'a because all rights, including the rights to own, originate from the Shari'a.

21. Islam does not allow any arbitrary expropriation of private property. The Qur'an (2:188) says: "And do not eat up your property among yourselves for vanities, nor use it as bait for the judges, with intent that ye may eat up wrongfully and knowingly a little of (other) people's property."

22. The zakat is an important social insurance or a provident fund for the community. It is the right of the less fortunate members of the community on the property of the rich. If the rich fail to pay the zakat, the government is responsible for enforcing it. When the proceeds from zakat are not sufficient, the government has the right to levy more taxes on the wealthy for budgetary purposes.

23. The Qur'an (4:5) says "To those weak of understanding, make over your property which God has made a means of support for you."

24. It was narrated that the Prophet (PBUH) has told one of his companions that he might fully water his fields and must leave the water to flow to his neighbour to benefit from it. The Prophet was also quoted as saying: "People are partners in three things: water, pasture, and salt," indicating that water is a common property.

26. The owner can regain the title to his/her property when he shows his willingness to refrain from *Israf*, or extravagant spending. During the decadence of the Roman Empire, the owners of agricultural domains were threatened with forfeiture of their property if they neglected to cultivate it [see Rodinson, 1978].

27. There are other unspecified rights on al-mal, over and above the zakat, specially during the time of emergencies and disasters. The Prophet (PBUH) was quoted as saying: "There are other obligations on al-mal other than zakat."

28. Islamic law places a great deal of emphasis on contracts and the necessity for participants to remain faithful to the terms specified in the contracts, so much so that faithfulness to the terms of contracts is considered a distinguishing characteristic of a Muslim. The Prophet was quoted as saying: "Muslims are bound by their stipulations." When the Prophet was asked about the believer, he replied: "A believer is one with whom the people can trust their person and possessions."

29. The institution of al Hissbah is based on the Islamic duty of enjoining the right and preventing the wrong. The Mohtassib, who oversees the Hissbah is a market monitor or regulator delegated by the authority to check on trading practices, e.g. measures, weights, etc.

30. *Ijtihad* is the jurist's use of his reasoning to find solutions to new problems while keeping in full view the intent and spirit of the Shari'ah. Methods of *ijtihad* include *qiyas* (analogical deduction), *istihsan* (preference of one *qiyas* over another or even abandonment of *qiyas* for some strong reason), or *al-masalih-al-mursalah* (judgement on the basis of public welfare).

31. The Islamic financing mechanisms include *Mudaraba*, *Musharaka*, *Murabaha*, *Ijara*, *Ijara wa iktina*, *Bai Mo'ajal*, *Salam*, and *Quard Hassan*.

32. The fact that the Prophet (PBUH) allowed share-cropping is an implicit acknowledgement of the efficiency of private enterprise. Public property should be *privatised* or managed privately through profit-sharing arrangements.



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