

## **Chapter 4:**

# **Islamic Economics**

## **Preview**

Islamic economics, which is founded on the principles of Islamic law, has been acquiring popularity among decision-makers for some time as a result of the interest it has garnered from numerous thinkers. It is regarded as one of the potential models for promoting growth and achieving sustainable economic and social development while avoiding the shortcomings of both capitalist and socialist systems. This chapter delineates the significance of Islamic economics and discusses its most critical components.

### **1. Definition of Islamic economics**

Islamic economics is defined as that economy that is based on Sharia rulings to find solutions to issues and problems that may confront economies by proposing laws and theories derived from Islamic Sharia and its sources (the Quran, Sunnah, and juristic reasoning) and then aligning with them to increase the efficiency of using and distributing limited resources in a way that enhances the welfare of societies and achieves financial and economic stability. Thus, many contemporary thinkers now view Islamic economics as an alternative to the current capitalist economic systems that have experienced financial crises, leading to the evaporation of wealth and resources<sup>1</sup>. Some have defined political economy as the economic structure based on the general economic principles derived from the Quran and Sunnah, according to each environment and time<sup>2</sup>.

Some define Islamic economics as the totality of general economic principles (Islamic rulings and regulations) derived from the Quran and Sunnah, aimed at organizing the earning and spending of money and its avenues of growth and organizing the economic and social relations that arise among members of society through the production and distribution of goods and the provision of services to satisfy people's needs. Thus, it does not differ from the contemporary economic concept, which focuses on satisfying people's needs as a general goal. However, it adds that the Islamic economic system also addresses a second aspect, which is providing a dignified life that respects value, nurtures the higher qualities of human beings, and rewards them in the hereafter<sup>3</sup>.

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<sup>1</sup> Ahmed Faiz Al-Harash, The Foundations of Islamic Economics and Its Impact on Economic Activity, Journal of Legal and Economic Research, Aflo University Center, Algeria, Volume 03, N° 01, 2020, p. 612.

<sup>2</sup> Kamal Hattab, The Role of Islamic Economics in Combating the Problem of Poverty, Yarmouk Research, Humanities and Social Sciences Series, 2002, p. 1302.

<sup>3</sup> Aouissi Amin, op.cit., p. 191.

Islamic economics is defined as aiming to achieve human welfare through the optimal allocation and distribution of resources in accordance with Islamic law, leading to the launch of individual initiatives to increase production without compromising the public interest, thanks to the encouragement of economic freedom constrained by the teachings of Islamic law to curb any negative behaviors that affect economic activity and harm the common good <sup>1</sup>. In other words, Islamic economics is viewed as the science and field that examines the use of human, natural, and material resources entrusted to humans by God to produce the maximum possible halal benefit that satisfies present human needs and distributes it fairly, while working on its development and growth in a manner that does not contradict Islamic law<sup>2</sup>.

Islamic economics is based on an economic doctrine formed by a set of economic principles and foundations that Islam has sanctioned, approved, and encouraged individuals to adhere to when engaging in their economic transactions. The Islamic economic doctrine seeks to describe economic phenomena and organize economic activity according to the principles of Islamic law to ensure the highest degree of effectiveness in achieving goals and fairness in income distribution. In turn, Islamic economics establishes an Islamic economic system that seeks to achieve moderation, satisfy legitimate material and spiritual needs, and avoid negative prohibited behaviors that adversely affect the normal functioning of economic activity<sup>3</sup>.

## **2. Characteristics of the Islamic economy**

The establishment of the Islamic economy on the principles of Islamic law confers it unique characteristics, which are:

### **2.1. Divine Source**

Islamic economics differs from other economic schools of thought; it is considered a divine contractual economy whose source is revelation and ijtihad (juridical reasoning) in light of it. It is based on doctrinal foundations that guide economic activity and achieve positive economic outcomes. Since Islamic Sharia rulings (divine legislation) are considered the most important sources of Islamic economic laws, the latter acknowledges many topics, including the right to practice all economic activities and engage in various transactions, except the criminalization

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<sup>1</sup> Souad Al-Badri, The Main Features of Islamic Economics in the Noble Prophetic Tradition, International Journal of Miraculous Interpretation and Scientific Research, Volume 01, N° 01, 2016, p. 54.

<sup>2</sup> Hind Mehdaoui, Islamic banking finance as an alternative solution to global financial crises, PhD thesis in Economic Sciences, Abou Bekr Belkaid University Tlemcen, Algeria, 2015/2016, p. 5.

<sup>3</sup> Abdul Majid Al-Hadi Abdul Aziz, Islamic Economics: Concept, System, and Science, Journal of Economics and Administrative Sciences, Vol. 01, No. 02, December 2019, pp. 97-100. 97-100.

of those that contradict Islamic Sharia rulings. In this regard, activities and transactions such as buying, selling, production, and consumption that comply with Islamic Sharia law are subject to Sharia regulations to frame them to achieve justice, ensure the benefit of all parties, enhance economic performance, and elevate the market to perfection in all aspects<sup>1</sup>.

## **2.2. Divine Purpose**

Since Islamic economics is divinely sourced, it aims to benefit the individual and the community by striving to satisfy the worldly material needs of individuals and groups in accordance with God's law. The goal of human economic activity and consumption is to please God and worship Him, not to amass wealth that God has entrusted to them to manage. Thus, Islamic economics differs from other schools of thought that view the individual's goal in engaging in economic activity as maximizing wealth and creating utility to satisfy material desires, regardless of whether those desires are permissible or forbidden<sup>2</sup>.

## **2.3. Realism**

Islamic economics is realistic in its principles, methodology, and objectives. It seeks to address the economic problems faced by individuals, communities, and nations without resorting to fantasy and illusions<sup>3</sup>.

The reliance of Islamic economics on realism in solving economic problems and prioritizing the community's economic needs has led it to acknowledge certain realities, such as the disparity in wealth and sustenance, individuals' love for wealth, and their never-ending dedication to acquiring as much as possible. At the same time, Islamic economics attempts to channel these inclinations and desires, subjecting them to comprehensive ethical and economic regulations, such as criminalizing speculation, monopolies, gambling, and excessive price hikes without objective reasons, as well as deferred and fictitious transactions that yield no benefit<sup>4</sup>.

## **2.4. Inclusiveness**

Some thinkers believe that Islamic economics encompasses all aspects of economic life. Thanks to its flexibility, it can address emerging economic issues and determine appropriate solutions and remedies for economic problems, making Islamic economics a comprehensive and integrated societal economic system that transcends temporal and spatial boundaries. Islamic economics relies on Islamic legislation to

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<sup>1</sup> Ahmed Faiz Al-Harash, op.cit., pp. 613-614.

<sup>2</sup> Ali Ahmed Al-Salous, Islamic Economics and Contemporary Jurisprudential Issues, Volume One, Dar Al-Thaqafa, Qatar, 1998, pp. 29, 30.

<sup>3</sup> Hind Mehdaoui, op.cit., p. 11.

<sup>4</sup> Ahmed Faiz Al-Harash, op.cit., pp. 614-615.

achieve comprehensiveness, intersecting with many disciplines and responding to various sciences<sup>1</sup>.

## **2.5. Universality**

Many consider that the universality and flexibility of Islam have allowed Islamic economics to be universally applicable in all times and places<sup>2</sup>. Islamic economics is founded on fixed principles that utilize changing and evolving tools, which are suitable for various cultural and social conditions, making it applicable in every society; this adaptability renders the Islamic developmental model the best and most appropriate<sup>3</sup>. Generally, a model is a set of methods for the organization of management, planning, or economic policy applied in a particular country at a particular time<sup>4</sup>.

## **2.6. Reconciling individual interests with the public interest**

One of the most distinguishing features of Islamic economics is the reconciliation and balance between individual interests and the public interest, with the public interest being prioritized in case of conflict between the two<sup>5</sup>. The individual's practice of economic activity freely and their love for ownership sometimes causes harm to others. Unlike capitalism, Islamic economics has set regulations for economic freedom that ensure the preservation of rights and the protection of society from the behavior of some individuals and their excessive use of influence and monopolization of resources. Providing an environment of justice and stability is considered ideal for encouraging investment, expanding economic activity, and subsequently providing job opportunities, increasing the overall welfare of society, and benefiting all individuals<sup>6</sup>.

## **2.7. Guided economic freedom**

To regulate economic freedom, Islamic economics guarantees the state's right<sup>7</sup> to intervene in monitoring and organizing economic activity and ensuring free interaction between supply and demand in the markets, known as the institution of Hisbah, collecting and distributing Zakat, monitoring markets and transactions, and ensuring

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<sup>1</sup> Ahmed Faiz Al-Harash, op.cit., p. 616.

<sup>2</sup> Ali Ahmed Al-Salous, op.cit., p. 43.

<sup>3</sup> Mohamed Al-Nouri, Fair Economy: Resource-Based Economy, Not Debt-Based Economy, International Journal of I'jaz for Interpretation and Scientific Research, Volume 03, N° 03, February 2018, p. 60.

<sup>4</sup> Wlodzimierz Brus, op.cit, p. 2.

<sup>5</sup> Ali Ahmed Al-Salous, op.cit., p. 35.

<sup>6</sup> Ahmed Faiz Al-Harash, op.cit., pp. 618-619.

<sup>7</sup> The concept of the state in Islam differs from it in Western references. In Islam, the state means a group of individuals (Muslims and non-Muslims) residing in a territory under the control of an authority whose ruler is subject to the supremacy of Islamic law, and they are subject to it, which is referred to as the House of Islam. As for the Western concept, it sees the state as a group of people residing in a specific territory, forming a political unity among them.

they do not violate Islamic law. Such an approach allows the state to play its role effectively in resource allocation, prevent individuals from misusing private property, and achieve common welfare. The state's functions include establishing justice among people, providing individuals with opportunities to access resources, achieving balanced welfare through infrastructure projects and development programs, and creating a suitable environment for investment.

In this regard, public investment in Islam is governed by regulations that align with the priorities of society. Priority is given to directing public investment towards necessities to cover essential activities, which leads to directing resources towards producing necessities and satisfying the most urgent essential needs. After fulfilling the necessities, public investment is directed towards needs that facilitate human life. The investment is directed towards improvements or luxuries that make people's lives easier, more comfortable, and more enjoyable without extravagance or excess<sup>1</sup>.

However, the purpose of intervention is to serve the public interest and not to harm society. The extent of intervention should be proportional to the necessity, avoiding excessive intervention that requires compensating the affected parties<sup>2</sup>. In Islam's view, the state does not restrict economic freedom unless there are strong justifications for doing so, based on the principle of preserving the public interest to provide justice, security, balance, and cohesion in society<sup>3</sup>.

## **2.8. Balancing material and spiritual aspects**

Islamic economics, based on the principles of Islam, attempts to reconcile and balance the material and spiritual aspects without one overshadowing the other and to enhance self-regulation while excluding material needs that contradict Sharia. Through this balance, Islamic economics can meet the material and spiritual needs of individuals and achieve happiness and satisfaction that drive increased economic activity<sup>4</sup>. Therefore, Islamic economics is often described as an ethical science, as it manages resources, wealth, and various economic activities based on divine values that call for adherence to integrity, justice, fairness, solidarity, cooperation, and other virtuous ethics<sup>5</sup>. In this regard, profit is not the only goal that individuals and production units

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<sup>1</sup> Saleh Salehi, Standards and Regulations for Investment in the Public Sector in Islamic Economics, Journal of Economic Sciences and Management Sciences, Ferhat Abbas Sétif University, Algeria, N° 07, 2007, pp. 2, 5, 6, 7, 8, 9, 10.

<sup>2</sup> Dalal Ben Tabi, Functions of Fiscal Policy in Islamic Economics: An Analytical Study, op.cit., pp. 14-15.

<sup>3</sup> Al-Mamouri Amer Imran & Al-Tameh Haidar Hussein, op.cit., p. 161.

<sup>4</sup> Souad Al-Badri, op.cit., p. 57.

<sup>5</sup> Jassem Al-Fares, The Foundations of Economic Thought in the Holy Quran, The Fourth International Scientific Conference on the Role of Islamic Economics in Building State Economies, University of the Holy Quran and Islamic Sciences, Sudan, November 7, 2018, p. 19.

seek to achieve from economic activity. Instead, Islamic economics aims to make ethical and humanitarian goals the driving forces of economic activity in order to make the economic system operate efficiently<sup>1</sup>.

## **2.9. Dual control**

One of the principles of Islamic economics is its reliance on dual oversight of all economic transactions and behaviors, such as buying, selling, investing, and consumption. Islamic economics combines worldly oversight stemming from state authority through financial and administrative monitoring and auditing and divine oversight that arises from personal conviction to avoid the spread of negative behaviors that harm economic activity, such as theft, embezzlement, usury, and corruption, which were among the causes of economic fluctuations and crises. The dual control system contributes to regulating the expenditure of public funds, improving resource allocation, and providing a suitable environment for increasing economic activity, monitoring it, and correcting any imbalances that may occur<sup>2</sup>.

## **2.10. Combining Stability and Flexibility**

Islamic economics is based on unchanging principles, such as the prohibition of usury, theft, embezzlement, the prevention of zakat and gambling, and the permissibility of sale. At the same time, Islamic economics is characterized by its flexibility to accommodate various transactions and innovative means, provided they do not contradict the fixed principles. Stability lies in the principles and objectives contained in the texts of the Quran and Sunnah. At the same time, flexibility is found in the branches, means, methods, and economic solutions revealed by scholars to implement Islamic economic principles. All of this is aimed at regulating human transactions and behaviors<sup>3</sup>.

## **2.11. Islamic Economics as part of the whole**

Islamic economics is considered a part of the complete Islamic system, including the social, political, and economic aspects, and it is based on monotheism and ethics. Islamic economics expresses Islam's perspective on justice and its method of organizing economic life, as it is part of the comprehensive Islamic system that interconnects, interacts, and integrates harmoniously and balances with the other components of Islam as a complete religion and way of life<sup>4</sup>.

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<sup>1</sup> Belhoussein Fatima Zahra, The Contribution of Applying Islamic Economic Principles in Limiting and Addressing the Causes of Financial Crises, PhD Thesis in Economic Sciences, Abou Bakr Belkaid University of Tlemcen, Algeria, 2017/2018, p. 144.

<sup>2</sup> Ahmed Faiz Al-Harash, op.cit., p. 621.

<sup>3</sup> Hind Mehdaoui, op.cit., pp. 10, 14.

<sup>4</sup> Dalal Ben Tabi, Functions of Fiscal Policy in Islamic Economics: An Analytical Study, op.cit., p. 6.

### **3. Goals of Islamic economics**

Based on its principles and characteristics, Islamic economics aims to achieve a set of goals, the most prominent of which are:

#### **3.1. Achieving comprehensive economic development**

Islamic economics seeks to increase growth and achieve comprehensive development by activating the three engines of growth, which are consumption, investment, and savings. Islamic economics seeks to achieve balanced and prudent consumption away from extravagance and stinginess, and to increase savings by combating hoarding and directing savings towards investment in productive real sectors, thereby increasing capital accumulation and production, meeting the basic needs of society, increasing income, creating job opportunities, reducing poverty rates, and narrowing the social gap<sup>1</sup>. Through the unique characteristic of Islamic economics, which emphasizes the balance between the spiritual and material aspects of economic life, Islamic economics seeks to increase economic welfare and make life more prosperous, encouraging individuals to strive diligently to seek the resources that God has placed on earth and benefit from them in accordance with Islamic teachings<sup>2</sup>.

#### **3.2. Enhancing social cohesion**

Islamic economics aims to promote cooperation, solidarity, and equity among individuals with economic justice that provides each person with economic opportunities based on their inclinations, talents, and capabilities without oppression or exploitation, whether they are consumers, producers, distributors, employers, or workers. Economic justice is manifested in fair wages for their contribution to production in an atmosphere of brotherhood, justice, and the supremacy of ethical values<sup>3</sup>.

Through social security and social solidarity, countries can increase social cohesion and mutual solidarity among individuals and between the government and individuals by enhancing their role in improving the standard of living for individuals and ensuring a minimum level of sufficiency<sup>4</sup>.

#### **3.3. Increasing economic growth and achieving economic stability**

To achieve sustainable growth, Islamic economics aims to develop and enhance human resources to increase their productivity and employ them correctly, avoiding excessive fatigue and depletion in fields of work that do not match the individual's

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<sup>1</sup> Mohamed Al-Nouri, p. 63.

<sup>2</sup> Belhoussein Fatima Zahra, op.cit., p. 145.

<sup>3</sup> Ibid, pp. 145, 146.

<sup>4</sup> Souad Al-Badri, op.cit., p. 56.



qualifications and talents. It seeks to utilize human capital in producing the required goods without depleting the community's resources <sup>1</sup>.

### **3.4. Achieving justice among individuals**

Islamic economics aims to reduce the gaps in economic levels among individuals by encouraging initiatives such as Zakat, charity, and activating the role of waqf<sup>2</sup>. These tools work to mitigate income disparities and the monopolization of resources by a particular group, which contradicts the essence of Islam and the goals of brotherhood and cooperation among individuals. Islamic economics is concerned with distributive justice, striving to ensure a decent minimum standard of living that preserves the dignity of the individual by providing suitable job opportunities and caring for individuals who are incapacitated for humanitarian and social reasons, such as disability, old age, compulsory unemployment, and others<sup>3</sup>.

## **4. Islamic economy's mechanisms to address to the economic problem**

In addressing the economic problem, Islamic economics proposes some tools that many thinkers consider effective due to their emphasis on justice and their avoidance of injustice towards one group at the expense of another. One of the most important of these tools:

### **4.1.1. Zakat**

Zakat plays important social and economic roles. Zakat can be defined as a certain amount of wealth that Allah requires the owner to hand over to those who are entitled to receive it<sup>4</sup>. It is an efficient tool for redistributing money from the rich *muzakki* (zakat donor) to the poor *mustahik* (zakat receiver) if it reaches a certain amount above the *nisab* for a year, therefore helping the poor and reducing the gap between the incomes of the rich and the poor and alleviating the problem of inequalities, enhancing societal security by taking a portion of the wealth of the rich and distributing it to the poor. This contributes to improving the fairness of income and wealth distribution, reallocating it to the poor and needy, increasing social cohesion, and achieving social balance and welfare in its spiritual and material components<sup>5</sup>. Historical experiences, especially in

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<sup>1</sup> Abdullah bin Abdul Mohsen Al-Turki, op.cit., pp. 137, 139.

<sup>2</sup> Souad Al-Badri, op.cit., p. 56.

<sup>3</sup> Belhoussein Fatima Zahra, op.cit., p. 146.

<sup>4</sup> Dianan Irfan Syauqi Beik & Khonsa Tsabita, Performance Analysis of Zakat Practices in East Lampung Regency using National Zakat Index (NZI), PUSKAS Working Paper Series, The National Board of Zakat (BAZNAS), N°10, August 2017, p. 3.

<sup>5</sup> Mohamed Ahmed Omar Babiker, The Theory of Economic Welfare in Islamic Economics and the Role of Zakat in Social Welfare, Journal of Social Studies and Research, University of El Oued, Algeria, N° 08, September 2014, p. 23.

the early periods of Islam, have proven that zakat is important; by taking a certain amount of money from the rich to spend it on the poor and needy, wealth is redistributed, contributing to solving many social and economic problems.

In addition to its social function, zakat contributes to improving economic performance by increasing investment and enhancing its efficiency through reducing costs and increasing revenue. This, in turn, creates suitable job opportunities for all qualifications and reduces the severity of poverty. Zakat prevents hoarding and reduces the incentive for it, as hoarding is a hindrance to the development of the earth<sup>1</sup>. Zakat is also considered a solution to various harmful phenomena, including inflation, deflation, economic stagnation, financing issues, unemployment, poverty, and other economic and social problems<sup>2</sup>.

Zakat can play an important role in managing fiscal and monetary policy. Zakat can be deferred during periods of recession to improve aggregate demand or to impact a specific sector or group. It can also be accelerated to control liquidity and inflation rates or to finance large developmental projects that require substantial funds, such as infrastructure and factories. Additionally, zakat can be used to improve the allocation of resources between luxury consumption and investment. By allocating a portion of income and wealth for distribution, zakat contributes to achieving economic balance. Zakat financing contributes to the proposed Islamic financing models, particularly participation, by providing capital for investment in real sectors. Thus, zakat financing helps achieve economic stability and balance between the real sector and the financial sector and avoids excessive money supply, which is a source of economic and financial instability that leads to waves of recession and depression affecting economies suffering from financial sector inflation at the expense of the real sector<sup>3</sup>.

In addition to the above, zakat contributes to financing economic development, as it is considered a significant and renewable financial resource since it is imposed on growth-capable funds, whether they are invested or not, including hoarded and frozen funds. Zakat helps avoid financial crises and economic fluctuations<sup>4</sup>. Thanks to the spending of zakat on establishing educational and health institutions, zakat contributes to the development of human capital and improving its productivity, enabling people experiencing poverty to enhance their educational level and obtain better job

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<sup>1</sup> Kawthar Al-Abji, The Miraculousness of Islamic Legislation in Preventing Financial Crises, *International Journal of Miraculous Interpretation and Scientific Research*, Vol. 01, No. 01, 2016, pp. 76, 80. 76, 80.

<sup>2</sup> Fatima Sayah & Khairunnisa Musari, *op.cit.*, p. 25.

<sup>3</sup> Dalal Ben Tabi, The structure of public financial revenues of a contemporary Islamic state – An analytical study –, PhD thesis in Economic Sciences, Mohamed Kheider University of Biskra, Algeria, 2012/2013, p. 100, 213-217.

<sup>4</sup> Kardoudi Sabrina, *op.cit.*, pp. 56, 57, 194.

opportunities or start their businesses. Thus, zakat supports human capital, improves individuals' living conditions, and ensures a decent standard of living (minimum sufficiency)<sup>1</sup>.

The hoarding of money causes negative repercussions on the economy, as it is considered a leakage from the income and production cycle, leading to the stagnation of part of the wealth and resources, which in turn causes a decline in production and its inability to meet the needs of society. Therefore, the fight against hoarding came through zakat by creating channels to employ those hoarded savings and invest them in productive investments with the best returns that align with the economic and social priorities of society and exempting them from paying the fluctuating interest costs that projects usually incur in conventional economies, which increases the yield of savings and investment. Hoarding leads to the scarcity of money and diverts it from its primary function of facilitating and settling transactions, turning it into a commodity with a price represented by the interest rate<sup>2</sup>. By combating hoarding, more money will flow into circulation, increasing consumer demand, which encourages investors to increase their investments to expand production capacities and emerge from recession<sup>3</sup>.

In addition to the above, zakat does not affect production capacities, as it relies on growth assets rather than assets that depreciate over time<sup>4</sup>. On the contrary, zakat contributes to increasing production, as production tools involved in production are exempt from zakat, except for net working capital.

The payment of Zakat and its distribution to the deserving poor in the form of money and to craftsmen and artisans in the form of capital for a productive project that can be owned contributes to reducing the marginal propensity to save among the affluent, decreasing their tendency to hoard, and increasing the marginal propensity to consume. This stimulates producers to increase capital accumulation and production to meet the rising effective demand for goods and services. Additionally, the guarantee of Zakat for the capital of the indebted can provide a strong impetus for the indebted producers to produce and reinvest to repay their debts, avoid losing their expertise and knowledge, and liquidate their investments to settle their debts. Consequently, Zakat contributes to reducing indebtedness and increasing production<sup>5</sup>.

Microfinance funded by Zakat is considered one of the most prominent forms of financing directed towards people with low incomes and debtors. It aligns with their capabilities and contributes to achieving financial justice. Typically, banks and Islamic

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<sup>1</sup> Dalal Ben Tabi, op.cit, p. 19.

<sup>2</sup> Hind Mehdaoui, op.cit., p. 25.

<sup>3</sup> Dalal Ben Tabi, op.cit., p. 24.

<sup>4</sup> Kawthar Al-Abji, op.cit., pp. 76, 80.

<sup>5</sup> Ashraf Dawab, The Economic Miraculousness of Zakat in Production, International Journal of Miraculous Interpretation and Scientific Research, Vol. 02, No. 02, 2017, pp. 146, 147. 146, 147.

financial institutions mediate between those wishing to lend their surplus funds as a good loan in the form of Zakat and donations and use it to finance those in need who can repay their debts<sup>1</sup>. Zakat is characterized by its ability to encompass a large group of beneficiaries from various sectors, allowing them to improve their conditions and performance and compensate for the decline in purchasing power due to inflation. The channels for investing Zakat are numerous, starting from financing those working in productive sectors such as agriculture, industry, and trade, to providing funding for those seeking to establish their investment institutions, including startups. In this context, Zakat funds can contribute to providing welfare services and to establishing companies with substantial capital, such as pharmaceutical companies with Islamic financing methods (partnership, profit-sharing, leasing, and qard el-hassan) whose profits go to charitable projects or to creating small businesses for people experiencing poverty, allowing them to improve their living conditions<sup>2</sup>.

#### **4.1.2. Takaful financing or Qard el-hassan**

Qard el-hassan *is* an Islamic finance instrument, referred to as a zero-return loan, benevolent loan, voluntary loan, soft loan, charitable loan, or beautiful loan<sup>3</sup>. Qard el-hassan is a social-welfare contract that provides interest-free loans to make funds available to those in need. Therefore, this loan is extended without any additional payment, benefit, return, charge, profit-sharing, or other compensation from the borrower. The lender expects a reward only from Allah<sup>4</sup>.

In Islamic economics, Qard el-hassan is a type of donation or 'tabarru' contract that provides microcredit, helping alleviate poverty. Microfinance institutions (MFIs) rely on this contract to provide people in need with small start-up capital by charging only a service or administration fee. Some scholars have noted that Qard el-Hassan serves as a meeting point between conventional MFIs and Islamic MFIs, as well as between conventional microfinance and Islamic microfinance, for financing people experiencing poverty. Poverty alleviation is the primary goal, so financing for people experiencing poverty should avoid interest rates.<sup>5</sup>

Therefore, Islamic banks have adopted the Qard el-hassan to enhance social solidarity in Islamic communities, as they provide financing to meet personal and family consumption needs such as housing, clothing, and other necessities of life, as well as investment needs for traders, farmers, artisans, and professionals to meet their

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<sup>1</sup> Mohamed Ahmine, the principle "So that it does not become a state among the rich of you" and its contemporary applications, International Journal of I'jaz for Interpretation and Scientific Research, Volume 03, N° 03, February 2018, p. 105.

<sup>2</sup> Tayeb Taybi, op.cit., pp. 201, 202, 203.

<sup>3</sup> Fatima Sayah & Khairunnisa Musari, op.cit., p. 26.

<sup>4</sup> Khaldi Khadija, op.cit., p. 37.

<sup>5</sup> Fatima Sayah & Khairunnisa Musari, op.cit., p. 27.

production needs for equipment, tools, raw materials, and more. The Qard el-Hassan is considered a crucial tool in financing development, as it provides the necessary funding to investors, thereby sparing them from the burden of interest imposed by conventional banks. This interest would otherwise turn into additional profits, enabling the investor to increase their savings. Thus, the qard el-hassan is considered one of the means to enable individuals to benefit from money, as the loan is repaid at the end of the agreed period without any interest or share in profits or losses<sup>1</sup>. The bank is happy with the loan's principal repayment, but it may charge for the loan's administrative costs and expenses, as long as they don't exceed the actual costs and aren't tied to the term<sup>2</sup>. Therefore, Qard el-Hassan enjoys widespread popularity in many countries, playing a decisive role in fostering sustainable development.

#### **4.1.3. Murabaha or installment sale**

Murabaha, or installment sale, is one of the tools used by Islamic banks to finance a wide range of operations without any suspicion of interest-based transactions<sup>3</sup>. Murabaha is called cost-plus financing, in which ownership of an asset is transferred to a customer through a bank after a series of payments that include a profit markup, without charging interest<sup>4</sup>.

It is a contract that allows the Islamic bank to purchase tangible assets, whether real estate or movable property, from a supplier and resell them to the customer upon request at the purchase price plus a profit margin. This is to avoid the stagnation and spoilage of goods if the bank purchases them without prior demand. This agreement specifies how the price of the property or asset will be paid, either in a lump sum or in periodic installments<sup>5</sup>. Under Murabaha, the transaction is a sale, not a loan, so the purchaser does not become the valid owner of the asset until the loan is fully paid, as with a rent-to-own<sup>6</sup> arrangement.

Murabah is an alternative to loans in diverse sectors; consumers use it when purchasing household appliances, cars, or real estate, while businesses use this type of financing when purchasing machinery, equipment, or raw materials. Murabaha is also

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<sup>1</sup> Hind Mehdaoui, op.cit., pp. 58, 59.

<sup>2</sup> Zaydi Maryam, op.cit., p. 50.

<sup>3</sup> Ibid, p. 50.

<sup>4</sup> Julie Young, Murabaha: Definition, Example, and Financing Under Islamic Law, 28 June 2025, consulted on 5 July 2025, at <https://www.investopedia.com/terms/m/murabaha.asp>

<sup>5</sup> Omar Hamza, Participatory Banks and Traditional Banks: Which Path?, International Journal of Interpretation and Scientific Research, Vol. 02, No. 02, 2017, p. 49.

<sup>6</sup> Rent-to-own is an agreement that offers an alternative path to homeownership for those unable to secure traditional mortgages, as it consists of a lease agreement and an option to purchase the home.

commonly used in short-term trade, such as issuing letters of credit for importers on behalf of an applicant or importer.<sup>1</sup>

#### **4.1.4. Ijarah or Leasing**

Ijara, or leasing, is one of the exchange contracts, under which the Islamic bank places a property or movable asset it owns at the disposal of the client for use in a manner that does not conflict with the law and Islamic Sharia during a specified period, after which the bank reclaims the leased property or movable asset. So, ijarah entails selling the right to use an object (usufruct) for a specific time, provided that the lessor must own the leased object for the duration of the lease<sup>2</sup>.

The owner of the asset (the bank) transfers all associated risks, and the asset can be sold at the agreed market price, leading to the sale of the lease contract. This contract can be structured as a lease and purchase agreement, where each payment for the lease includes a portion of the agreed purchase price, and it can be executed within a timeframe that covers the estimated lifespan of the asset<sup>3</sup>. In other words, under an Ijara contract, the lessor agrees to sell the leased object at the lease's end at a predetermined residual value<sup>4</sup>. This promise binds only the lessor. The lessee is not obligated to purchase the item<sup>5</sup>.

The permissibility of lease contracts aims to achieve a public benefit by allowing individuals to benefit from what others own. The lessee may require the lessor to maintain the leased assets, whether the defects existed before the lease or whether the maintenance cost was known or unknown on the day the lease contract was signed<sup>6</sup>. The lease contract is considered an alternative when the client finds themselves in need of renting the product for a specific period.

Unlike the Murabaha contract, the Ijarah contract functions as a lease agreement, allowing the client to use the product for the duration of the contract. Eventually, the client will stop paying rent and return the property to the lessor or have the option to purchase the asset, similar to a purchase contract. In the case where the client wishes to purchase a house that has already been built but does not have the necessary funds,

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<sup>1</sup> Julie Young, op.cit.

<sup>2</sup> Marc L. Ross, Working With Islamic Finance, 10 January 2025, consulted on 5 July 2025, at [https://www.investopedia.com/articles/07/islamic\\_investing.asp#:~:text=Leasing%20\(Ijarah\)&text=A%20variation%20on%20the%20lease,obligated%20to%20purchase%20the%20item.](https://www.investopedia.com/articles/07/islamic_investing.asp#:~:text=Leasing%20(Ijarah)&text=A%20variation%20on%20the%20lease,obligated%20to%20purchase%20the%20item.)

<sup>3</sup> Sattar Mehdi, op.cit., p. 5.

<sup>4</sup> Residual value is an asset's estimated worth at the end of its useful life.

<sup>5</sup> Marc L. Ross, op.cit.

<sup>6</sup> Mohammad Suleiman Al-Ashqar, The Regulations Governing the Maintenance Contract of Leased Properties and the Implications for the Lessor and Lessee, Mohammad Suleiman Al-Ashqar et al., 1st edition, Jurisprudential Research in Contemporary Economic Issues, Volume One, Dar Al-Nafaes for Publishing and Distribution, Jordan, 1998, pp. 304, 313.

the bank prepares a Murabaha contract. However, in the situation where the client needs financing to construct a building, they can use an Istisna contract.

#### **4.1.5. Musharakah or Partnership**

Musharakah is a joint enterprise or partnership structure in Islamic finance in which partners share in the profits and losses of an enterprise, avoiding any involvement of interest in lending, so the financier of a project or company can achieve a return in the form of a portion of the actual profits according to a predetermined ratio; the financier shares in any losses that may occur on a pro rata<sup>1</sup> basis.

Musharakah is one of the fundamental forms of activity in Islamic financing. It is frequently used for purchasing property and real estate, providing credit, investment projects, financing large purchases, and other lucrative ventures<sup>2</sup>. The purpose of the Musharakah contract is for the Islamic bank to share its money with another party's effort in a project to achieve profit, where the parties contribute to bearing the loss in proportion to their share in the profits, so that the gain is in accordance with the loss as per the agreement. Accordingly, the Islamic bank aims to select projects with a low level of risk, even if their profits are modest. In this, the Islamic bank differs from the traditional bank, which grants loans to high-risk projects in order to obtain high interest<sup>3</sup>.

#### **4.1.6. Mudarabah or partnership**

Mudarabah is a profit-and-loss-sharing contract used by the Islamic bank that pools investors' money and assumes a share of the profits and losses with the agreement of the depositors<sup>4</sup>. Some have defined Mudarabah or Qard as a contract that links an Islamic bank or several Islamic banks with one or more contractors, whereby the bank (the capital provider) provides the capital to the contractor (the entrepreneur), who exerts effort to make the project successful in exchange for the contractor's commitment to manage the project to achieve profits that are shared according to the terms of the contract. An entrepreneur, according to Israel Kirzner, is the person who talks of new products, new qualities of products, new methods of production, and new forms of organization that are endlessly generated in the course of the entrepreneurial process<sup>5</sup>.

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<sup>1</sup> Pro rata is a Latin term that translates to "in proportion," so dividends are awarded to investors based on their investment.

<sup>2</sup> Will Kenton, What Is Musharakah? Meaning and How It Works in Finance, 7 August 2024, consulted on 5 July 2025, at <https://www.investopedia.com/terms/m/musharakah.asp>

<sup>3</sup> Omar Hamza, op.cit., p. 94.

<sup>4</sup> Marc L. Ross, op.cit.

<sup>5</sup> James M. Buchanan & Viktor J. Vanberg, op. cit., p. 384.

Thus, the Islamic bank, according to the Mudarabah contract, bears the losses unless it is proven that the contractor violated the terms of the contract, was negligent, acted fraudulently, or mismanaged the project<sup>1</sup>. Mudarabah allows for the investment of collective capital from multiple resources and sources and facilitates the expansion of economic activities by linking capital from one party of the mudarabah with the labor that practices the mudarabah process. The capital owner may lack the time and expertise to carry out the required tasks that are expected to yield significant profits. Similarly, the labor and expertise owner may not have the capital to complete their project, thus creating job opportunities and providing capital for various economic activities<sup>2</sup>.

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<sup>1</sup> Hind Mehdaoui, op.cit., p. 34.

<sup>2</sup> Belhussein Fatima Zahra, op.cit., p. 347.



## **Summary**

Islamic economics, rooted in Islamic Sharia, offers a competitive alternative to secular systems, promoting economic and social stability. It uses an investment financing model and profit and loss sharing, offering adaptability to client needs and funding diverse productive endeavors. Unlike conventional financial systems, Islamic economics is more sustainable and less susceptible to financial crises.