

Search for a Rational, Equitable and Compassionate Economic System: A Theoretical Analysis of Key Factors

Javed Iqbal Shah* & Saman Javed**

Abstract

Until now, the world economies are being run by economic systems like, capitalism (the so-called free market), socialism/communism and mixed economy. In recent decades, we have witnessed one economic crisis after another, resulting in colossal loss to the world economies, and none of these systems has displayed its capability and capacity to prevent such crises from occurring or re-occurring. Therefore, several organisations and individuals have accepted this challenge and are in the process of devising an alternative economic system. This study will take into account the key aspects of the today's most dominating economic system i.e. capitalism as well as its implications on various economic variables. It will further provide insights into the methods and gateway towards a more rational, equitable and compassionate economic system. Particular attention has been paid to the economic norms and principles of Islam that can be major contributors towards this process. The aim of the authors of this paper is to aid in their humble capacity to explore ways of introducing an alternate economic system, which addresses the challenges of 21st century. It is envisaged that salient principles and commandments of Islam can serve as beacons of light for devising such an economic system. While conducting the research, the author would get relevant data, information, etc from various sources like books, articles, relevant papers, records and internet websites.

Keywords: Economic system, Economic crises, Capitalism, Islam

Introduction

The human race is living in a world run by an economic system, which is not only severely anti-poor, anti-reform, and anti-justice; but also cruel to the extent that it is ensuring concentration of the resources among a selected class while virtually forcing a vast majority to live on the brink of hunger, disease and catastrophe. Through tacit arrangements of international treaties coupled with some arm twisting, rich countries are becoming richer; while the poor nations are becoming even poorer through transfer of their precious resources to the already affluent nations. At individual level, instead of solving multifarious problems of

* Javed Iqbal Shah is a freelance writer. Email: javediqbalshah@outlook.com

** Saman Javed, M.Phil Scholar, Department of Leadership and Management, National Defence University, Islamabad

the people and bringing them peace, contentment and joy; the present economic system has brought about greed, obscurity and misery to billions of voiceless people. Due to dominance of a few rich and mighty individuals, corporations and ruling classes, with their insatiable lust for money, power and control over the shared resources of this world, the common people are made to suffer economic crises one after the other. During the last three years of the first decade of the new millennium, the world has already endured several economic catastrophes. From jacked-up petroleum goods prices to real estate fiasco in United States of America, from major bankruptcies in the financial sector to unprecedented hike in agricultural goods, and from engineered crashes of stock exchange markets to dominance of well-known cartels in several key economic sectors, the lust of the rich for more and even more appears to be unappeasable. Bungling at such a colossal level in various sectors has facilitated siphoning-off of billions and trillions of dollars and surprisingly enough, not a single person, corporation or cartel has been pointed out.

Present human race has suffered enough and it is utterly fed up with the current economic system, which has failed to address and mitigate the woes of the people at large. Thus, the humanity is looking for an alternate economic system, which apart from being rational and simple, must be humane, equitable and capable of providing solutions to the contemporary economic problems.

Statement of aim

The vital aim of this paper is to devise an economic system, which in addition to being rational and productive, is also equitable and compassionate as well as addresses the economic woes, needs and aspirations of the common man.

Literature Review

The edifices of the Current Capitalist system are based on the notion that most of economic actions of man are generated by self-interest of the incumbent. Adam Smith, who is widely hailed as father of economics, prophesied in his classical treatise, the Wealth of Nations that man's actions in self-interest would ultimately lead to collective good. Secondly, the financial system of the Capitalist economy runs on the rate of interest. Reilly & Brown are of the opinion that in a capitalist or free economy, interest is regarded as a tool to minimize risk and uncertainty on one's money or capital. (Reilly & Brown, 2011) Wonnacott & Wonnacott indicate that classical and neo-classical economists usually stress on saving and investment for an economic system to remain healthy and flourishing. (Wonnacott & Wonnacott, 1982) The concept of free trade emphasizes that international trade without restrictions

would be mutually beneficial for rich as well as poor nations. Ayn Rand (2013) argues that capitalism recognizes individual rights, including property rights.

Salient Features of Capitalist Economic System

Though genesis of the present capitalist system are usually claimed to emerge from the Industrial Revolution; yet its origins can be traced as far back in history as the era of the Crusades in the form of open cooperation and collaboration between the Church and the trading classes of the time. With the passage of time, it has assumed certain features, which make it unique among other economic systems. As a student of economics, one can identify the following salient features of Capitalist Economic System.

Not based on some divine or religious edict

The very first feature of the current economic system functioning in most of the Western democracies and elsewhere in the world is its secular foundation. Initially, the ruling classes of the Medieval Europe sought to seek approval for various policies and actions, especially in the realm of slave trade, subjugation of the Red Indians in America, the Aborigines in Australia and other local populations in their own land from the Church and the Clergy.

Such coalitions between ruling elites and the Church, however, started waning after the Renaissance. Later, separation of the church and the state affairs got substantial boost from the Industrial Revolution. Ultimately, the last century sealed the religious sanction of any individual act or functioning of business and state from any interference from the religion. Thus, initially the rulers, whether elected or Monarchs, and later the states became sovereign in running the national affairs. In such atmosphere, the ruling elites started accumulating power and authority unto their positions, and as a result, big businesses, companies and multinational corporations flourished. Now, at start of the second decade of new millennium, one finds out that even most of the states and the popularly elected governments have become weaker and have become mere stooges of the Ultra-powerful Corporations and Business Cartels. Thus, today the capitalist economies are being run, not by the laws of demand and supply, but by the forces of the vested interests, which seem to have conquered the rational market forces.

Individualism and self-interest

Although individualism and self-interest have always remained hallmark of human societies across different cultures; yet these attributes got further boost and endorsement by the writings of Adam Smith, who prophesied that man's actions in self-interest would ultimately lead to

collective good. Layton (2013) in her article described smith's concept of capitalism as a constituent of two concepts:

- *“Because self-interest guides producers to create exactly what people want, the pursuit of personal gain eventually benefits society.*
- *An economy has a natural design. Left to its own devices – and removed from politics, religion and all other pursuits – it will regulate itself. As long as no one throws a spoke in the wheel, the economy will work the way it's supposed to, and everyone will benefit.” (Layton, 2013, www.howstuffworks.com)*

Market functioning through demand and supply mechanism

Third and perhaps the most important feature of a capitalist economy is its proclaimed functioning through forces of demand and supply. Left on their own, these forces steer several functions of the economy. Therefore, in an ideal market, no entrepreneur can manoeuvre the mechanism of demand and supply due to presence of a large number of buyers and sellers. However, there is no ideal capitalist market in the contemporary world. Powerful individuals, cartels and multi-national corporations have since long conquered the forces of demand and supply to their exclusive advantage.

Interest-based transactions

Foundations of a financial system in a capitalist economy are laid on interest factor. Interest is defined as “the fee charged by a lender to a borrower for the use of borrowed money, usually expressed as an annual percentage of the principal; the rate is dependent upon the time value of money, the credit risk of the borrower, and the inflation rate.” In a capitalist or free economy, interest is regarded as a tool to minimize risk and uncertainty on one's money or capital. Interest rate covers the inflation, risk associated with the transaction and time value of capital (Reilly & Brown, 2011).

Emphasis on saving and investment

Classical and Neo-classical economists usually stress on saving and investment for an economic system to remain healthy and flourishing. But, what is meant by saving and investment? Wonnacott and Wonnacott define saving as what is left of disposable income after consumption expenditures; while investment is considered as the process of producing and accumulating capital. (Wonnacott & Wonnacott, 1982) Thus, people are lured to consume less for the time being and save more so that sufficient financial resources are available to purchase capital goods, which in turn would increase their incomes in future through increased production of goods and services.

Free trade

Since 1990s, free trade and free market economy have attained the stature of the entire capitalist economic system. It is often claimed by the proponents of the capitalist system that international trade without any restrictions, quota or tariff would be mutually beneficial for all, the rich and the poor nations. However, Monbiot (2008) points out the self-contradictions of the proponents of free trade in his article.

“The people of these countries know that trade is essential to pull them out of poverty. But they also see that unless it is conducted fairly it impoverishes them more. Many are aware that the European equation of fair trade with free trade is nonsense.”

Today, most of the developed countries are lessening the trade restrictions asserting that that free global trade would bring economic prosperity throughout the world. Contrary to it, these nations deterred the conduct of international trade unless their own economies flourished enough to expand across the borders.

“By 1816 the US had imposed a 35% tax on most imported manufactures, which rose to 50% in 1832. Between 1864 and 1913 it was the most heavily protected nation on earth; and the fastest-growing. It wasn't until after the Second World War, when it had already become top dog, that it dropped most of its tariffs. The same strategy was followed by Japan, South Korea, Taiwan and almost every other country that is rich today.” (Monbiot, 2008, The Guardian)

Sanctity of private property and personal preferences

Capitalist economic system stresses on the sanctity of private property and personal preferences in business transactions to the extent of a religious fervour. Ayn Rand was the first person to endow capitalism with a new code of morality – rational egoism. She argued that capitalism is the only morally valid socio-political system because it allows people to be free to act in their rational self-interest (Rand, 1964). She further added: "Capitalism is a *social system* based on the recognition of individual rights, including property rights, in which all property is privately owned." (The Ayn Rand Lexicon, 2013) However, Rand's efforts to present capitalism in the garb of "*A New Code of Morality*" were thwarted long before by Karl Marx in his epoch-making treatise, *Capital* in the following words,

“The treatment of the aborigines was, naturally, most frightful in plantation-colonies destined for export trade only, such as the West Indies, and in rich and well-populated countries, such as Mexico and India, that were given over to plunder. But even in the colonies properly so called, the Christian character of primitive accumulation did not belie itself. Those sober virtuosi of Protestantism, the Puritans of New England, in 1703, by decrees of their assembly set a premium of £40 on every Indian scalp and every captured red-skin: in 1720 a

premium of £100 on every scalp; in 1744, after Massachusetts-Bay had proclaimed a certain tribe as rebels, the following prices: for a male scalp of 12 years and upwards £100 (new currency), for a male prisoner £105, for women and children prisoners £50, for scalps of women and children £50. Some decades later, the colonial system took its revenge on the descendants of the pious pilgrim fathers, who had grown seditious in the meantime. At English instigation and for English pay they were tomahawked by red-skins. The British Parliament proclaimed bloodhounds and scalping as "means that God and Nature had given into its hand." (Marx, 1887, p. 529)

Monbiot (2010) commented on personal greed of those living in the West in his article, *Money's Hunger* in the following manner.

"The wealthy nations are plundering not only their own resources. The environmental disasters caused by the oil industry in Ecuador and Nigeria are not driven by Ecuadorian or Nigerian demand, but by the thirst for oil in richer nations. Deforestation in Indonesia is driven by the rich world's demand for palm oil and timber, in Brazil by our hunger for timber and animal feed." (Monbiot, 2010)

The above-mentioned list is neither comprehensive nor exhaustive; it is just suggestive to mark some of the important parameters of the Capitalist Economic System. In a nutshell, one may conclude that it is the Capitalist Economic System, which pushes people to carry on any economic activity, which appears to be in their best interest. Though restrictions/embargoes have been imposed on certain activities like narcotics, gunrunning, smuggling, unfair trade practices, proliferation of nuclear, biological, chemical substances and other weapons of mass destruction; nevertheless, several harmful and unethical activities are still permissible under the garb of free economic system. For instance, activities involving alcoholic drinks, tobacco, prostitution, pornography, gambling, etc are still legal and permissible in most of the countries though hardly anyone would deny their harmful consequences both at individual and collective levels.

Fundamental Principles of an Alternate Economic System

Universal failure of the Capitalist Economic System to deliver a principle-centred, viable and a compassionate economic order in the contemporary world has encouraged the economic theorists, academia and practicing economic managers to increase their efforts for an alternate economic order, which could solve the economic problems of the world. In the following part of this study, a brief framework has been presented to comprehend the most fundamental principles of an alternative economic system. If put into practice, these principles are likely to contribute towards laying the foundations of a rational, equitable and compassionate economic system.

Belief system

Belief system, also termed as “Imaniyat” comprises of five fundamental beliefs, namely, Belief in Allah, His Last Prophet Muhammad (PBUH), His Angels, His Scriptures and the day of judgement (Shah, 2006). Muslims having embraced the belief system turn away from materialism and expect their reward from Almighty Allah. The belief system of Islam:-

- i). *"Dissuades the believers to indulge in unethical practices due to fear of accountability by the All Powerful God at any time.*
- ii). *Motivates people to speak and stand up against unethical deeds since they know that nothing wrong could happen to them or to their family without the will of God. And, whatever is the will of God that is always in the best interest of a true believer.*
- iii). *Reminds intermittently that reward from Allah Almighty for good deeds is always far better than the worldly benefits gained through unethical means."* (Shah, 2006, p. 111-112)

Introduction of any system or a framework requires that all the concerned beings must have some set standards or beliefs that guide their way forward. Such a notion seems quite farfetched within the context of economics, since economic activity is merely viewed as a process of generation and utilization of wealth. On the other hand, Islam provides a complete set of values which if embraced, regulates people in the most desirable fashion. An Islamic economic system shuns greed, materialism and dishonesty. Belief system or “Imaan” enables the Muslims to carry out economic transactions and commercial activities morally and ethically.

Interest ('Riba') - free transactions

Elimination of riba or interest is indispensable for Islamic economic system. But introducing an economic system completely devoid of interest is not easy to accomplish. Several researchers in the past have shed light on the pros and cons of introducing an interest free system and also the otherwise. Different mathematical models have also been proposed to determine the relative advantage of both the systems. Nevertheless, most of the studies in this regard have established that elimination of interest can help build not only a better economic system but also presents solutions for problems like unemployment and inflation (Zangeneh, 1995).

Although abolition of interest leads to long term economic growth, it increases risk and uncertainty since profits depend upon equity based investments and transactions. As a result, savings fall while people consume more (Zengeneh, 1995). Thus, interest free transactions encourage circulation of money and hinder hoarding. On the other hand, interest based transactions results in uneven distribution of wealth

thereby creating economic disparity and social unease in the society. As said in the Holy Qur'an,

“O you who believe, do not practice usury, charging doubled and redoubled (interest); but have fear of God: you may well attain your goal.”(Al-Qur'an, 3: 130)

Interest has been confused with the notion of profit. Earlier in history soon after the emergence of Islam, traders regarded riba (interest) as something similar to the profit they used to earn on through trade. This claim was nullified by the Holy Qur'an.

“Those who live on interest will not rise (on Doomsday) but like a man possessed of the devil and demented. This because they say that trading is like usury... God takes away (gain) from usury, and adds (profit) to charity; and God does not love the ungrateful and sinners.” (Al-Qur'an, 2: 275 – 276)

Adherents of capitalism, although having defended riba as an economic growth mechanism, understands the underlying discrepancies of an interest based economic system. Increasing understanding of the debt burdens resulting from compounding interest has led the wealthiest countries to soften the debt obligations for the poor nations. Under the initiative “heavily indebted poor countries” \$36 billion have been provided to 30 states, aimed to rid them of debt obligations, mainly interest expenses (Daniels, Radebaugh, Sullivan & Salwan, 2009).

“O believers, fear God and forego the interest that is owing, if you really believe.”(Al-Qur'an, 2: 278 – 279)

Real domestic product instead of gross domestic product

Economists use the measure of Gross Domestic Product (GDP) as sum total of tangible worth of all the goods and services produced in a country in one year (Khawaja, 2005). Although being widely used as an indicator of economic performance, GDP does not include several aspects of a working economic system. Eisler in her speech at a session of UN pointed out that people performing household activities have been regarded as “economically inactive” since they are not holding a real job. She further stated that astounding growth rate can be realized if the activities performed by women in their homes are quantified. She said that if only chores done by Swiss women are quantified, they constitute 70% of the Swiss GDP (Eisler, 2009). Another problem with the concept of GDP is that it does not distinguish between the beneficial and harmful economic activities. For instance, incomes generated through such activities as gambling, prostitution, works and services generated after natural calamities like earthquake, flood, even terrorism are included in GDP of a nation. Islam, on the other hand, distinguishes between beneficial and harmful economic activities.

The concepts of halal and haram

Apart from the measuring tools of economic performance, the concepts of halal and haram are benchmark of an Islamic society. Halal is something permissible whereas haram refers to all the things or practices forbidden (Jallad, 2008). Thus, Islamic principles whether practiced in any sphere of life necessitate the Muslims to observe halal and haram. It is a control mechanism that regulates the activities of all the social beings and ensures smooth running of social systems. According to the commandments of Allah (SWT), acceptance of halal and haram is of utmost importance in an Islamic community as is obvious from the following verses of the Holy Qur'an.

“O believers, do not usurp unjustly the wealth of each other, but trade by mutual consent; and do not destroy yourselves, God is merciful to you. If someone does so through oppression or injustice, We shall cast him into Hell: This is how (the Law of God) works inevitably.”(Al-Qur'an, 4: 29 – 30)

The purpose of devising the boundaries of permissible and forbidden enables the people in a society to honour the rights and privileges of fellow citizens as well as enjoy their own. Furthermore, it provides a unique plan of action for the economists so that they can devise prudent economic policies that are in line with principles of halal and haram thus aiming to lessen the miseries of poverty, unemployment and social and economic instability. Conversely, the absence of these control systems can create crime, corruption and economic unevenness.

Economic justice and distribution of wealth

Divine commandments about distribution of wealth are essential parts of the Islamic economic justice. This implies that an equitable economic system allows the people, consumers and investors to earn fairly in return for their effort and investment. Islamic economic system contains elaborate inheritance edicts to ensure distribution of wealth in the society. In capitalist economic system, the typical indicators of income distribution like per capita income do not truly indicate that how much portion of income is going what sections of society (Daniels et al, 2009). An interest based economic system encourages concentration of wealth in few hands, resulting in rich becoming richer and poor becoming poorer. On the other hand, Islamic banking system holds each and every entity accountable in a financial transaction. Unlike interest, when profits are realized in an Islamic banking system, everybody gets the share. Similarly, if losses are incurred, they are also divided. But in an interest based system, there are cumulative gains for the rich while the poor get the burden of interest payment (Ismail, 2010).

Economic inequities also emerge when the economic system promotes and consolidates huge wage differences on the basis of

education, experience, status, knowledge and expertise or skill. Therefore, huge wage differentials appear between the highest and the lowest paid individuals. Hardly anyone bothers to see whether the lowest paid person would be able to satisfy the basic human needs in a dignified manner or not. Following verses of the Holy Qur'an clearly indicate a warning to people, who do not adopt equitable behavior while making economic transactions.

"Woe to those, who give short measure, who insist on being given full when they take from others, whilst when they measure or weigh for them, give less. Do they not think they will be raised (to life) again on a grievous day, the day all mankind will stand before the Lord of all the worlds?" (Al-Qur'an, 83: 1-6)

Emphasis on spending and long-term investments

Quite opposite to the Capitalist Economic System, Islam emphasises on spending instead of saving. However, this spending ought to be to please Allah (Subhana Wa Ta'ala) and not to show off ones' riches. This point is emphasised at several places in the Holy Qur'an, for instance,

"So give to your relatives what is their due, and to those who are needy, and the wayfarers; and do not dissipate (your wealth) extravagantly. Those who dissipate (their wealth) are the brethren of the devils, and the Devil was ungrateful to his Lord." (Al-Qur'an, 17: 26 – 27)

Several literary contributions in this regard have stated that Islamic economic system will result in increased spending and consumption. Since the Islamic economic environment is more risky and uncertain, thus people will prefer to spend today rather than saving for future. On the other hand, decreased savings will eventually lead to a decline in long term investments. But one can counter argue that amount of savings are determined more by income level than risk factor (Zengeneh, 1995). Thus, Islamic economy not only gives way to spending and healthy circulation of wealth but also do not constrain the savings and investments.

The concepts of zakat and taxation

The word zakat means "to purify." In Islam, zakat is the payment of 2.5% of the total wealth of a Muslim, who possess more than 7 ½ tolas of gold or 52 ½ tolas of silver or having equal amount of wealth. Zakat has also been regarded as "poor due", in other words, right of the poor in the incomes of the affluent people of the society. Like "Salat", it is one of the fundamental pre-requisite of "Imaan" and is obligatory on all well-to-do Muslims to give the poor their due share in the form of the prescribed percentage of their wealth as zakat. In Holy Qur'an, Allah (SWT) makes

it clear in the following verses that zakat is the share of the poor in the wealth of the rich,

“Be firm in devotion; give zakat (the due share of your wealth for the welfare of others), and bow with those who bow (before God).”(Al-Qur'an, 2: 43)

“In whose wealth the suppliant and the deprived had a share.”(Al-Qur'an, 51:19)

Here, it is worth-mentioning that Islamic concept of "Rizq" livelihood or sustenance is quite different from the prevailing capitalist system. As is mentioned at several places in the Holy Qur'an that the size of sustenance is decided by Allah (SWT). Therefore when someone gives zakat to the poor and the needy, he should not consider it merely as charity, which he gives due to his own generosity; rather, it is simply the share of the poor, which was given by Allah (SWT) to the rich so that they can return it back to the poor. Thus, one can consider payment of zakat as payment of one's debt.

Ahmed Ali considers Az-Zakat as to better, to increase as well as welfare, betterment, growth, etc, as *azka* means that which has goodness, gives nourishment. On socio-economic aspects of zakat, Ahmed Ali says:-

“Being the socio-economic aspects, the dimensions of zakat are collective, and its purpose of nourishment, growth, betterment and welfare cannot be achieved without the participation of each individual by contributing to the common good physically or intellectually as ita-e-zakat, and by contributing from his wealth to enable the people, the institutions, or government setup to administer the affairs of the people in an Islamic Order.”(Ali, 1995, p. 290)

In comparison to the taxation structure of today's economies, zakat is the better tool to cope with poverty, inequity, indifferent attitudes towards miseries of downtrodden people and other such socioeconomic ills. The system of zakat is based on the natural inclinations of the God-fearing people to spend in the way of Allah to please Him, to purify their incomes, to show solidarity with the poor, and to keep on receiving the increased bounties of their Lord. It not only ensures relief to the poorer sections of the community, but also aims at growing the overall economy by continuous circulation of wealth among all sections of the society. In this regard, Afzal-ur-Rehman says,

“One of the most important aims of zakat is to narrow down the economic inequalities in the community to the minimum possible limit. Its purpose is to keep the economic differences among the people within just and equitable limits so that the rich may not grow richer (by exploiting the less fortunate members of the community) and the poor poorer.”(Rahman, 1976, p. 192)

Unlike taxation in a capitalist economy, yearly cycle of zakat flourishes and stabilizes economy, ensures money circulation and helps in eradicating unfair distribution of wealth and immoral economic practices like hoarding and gambling. As Abdullah and Suhaib (2011) put it,

“If Zakat is established as an institution, it will create a collective social security scheme for mutual help/ sympathy and the resources can be further utilized for social development.” (Abdullah & Suhaib, 2011, p. 85)

Conclusion

In this paper, salient elements of the contemporary Capitalist Economic System are discussed to highlight their inadequacies to correct the myriad economic maladies suffered by a vast majority of this world. To start with, capitalism as an economic system is not based on some divine or religious edict. Other elements include individualism, self-interest, demand and supply mechanism, interest-based transactions, emphasis on saving and investment, free trade, sanctity of private property and personal preferences. In a nutshell, capitalism has been noted to be functioning to give undue leverage to the rich and powerful of this world. As a system, it has miserably failed to respond to the needs and aspirations of people across the globe. Rather, time and again, it has been looking after the interests of the select few. After having discussed various aspects of the contemporary capitalist economies and comparing them with desirable characteristics of an alternate economic system, no one can deny that there is a pressing need to change the existing economic structures and to devise a rational, equitable and compassionate economic system in the light of Islamic teachings. Salient principles of the Islamic economic system include the belief system of people, interest-free economy, Real Domestic Product as measuring tool of economic wellbeing, economic justice and distribution of wealth, emphasis on spending and long-term investment, and introduction of Zakat in the society. It is envisaged that Islamic Economic System has a workable framework to address the economic challenges of this millennium.

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