

PUBLIC BORROWING

in Islamic Perspective

The records of public borrowing examined in this brief study present an interesting contrast. On the one hand we have the most responsible of rulers borrowing for need fulfillment and jihad/defense even when no future revenues were immediately in sight. On the other hand, the records show irresponsible regimes in an age of affluence forced to borrow for bridge-financing, even if they had to violate the prohibition of interest. The strongly worded indictment of public borrowing by jurists like Imam al Haramain al Juwaini (419-478 A.H.) is largely in response to the sorry state of affairs that Abbasids had reached in the fourth century A.H. Given fiscal responsibility and adherence to the maqasid al shari'ah a different view is more convincing. Much further research is needed to trace the history of public borrowing in the thousand years that separate us from the period studied in this paper. Any guidelines for contemporary policy making will be better drawn after such a research, even though the decisive factors should be the contemporary situation and the example of the Prophet (saw) and his companions.

PUBLIC BORROWING IN ISLAMIC HISTORY.

The Prophet (saw) is known to be a frequent borrower in his private capacity at least in the difficult years in Madinah, but reports relating these borrowings do not concern Siddiqi's article. He has noted only those cases where the Prophet (saw) borrowed as the leader of all Muslims and the head of the state he established in Madinah. It is not at all difficult to distinguish between the Prophet's personal borrowing and his borrowing for public purposes since the texts themselves facilitate such a distinction.

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Siddiqi's research has so far led us to six cases of public borrowing by the Prophet (saw). In summary, the following can be noted. The Prophet (saw) borrowed both in cash and kind, in small amounts as well as large, from Muslims as well as non-Muslims, from men as well as women. The purpose of borrowing was need fulfillment or defense. But also borrowed to pay off more urgent debts.

No coercion was involved in his borrowing. Nor did it stipulate repaying more than what was received as loan. He borrowed when he did not possess, in cash or kind, what could meet the purpose in view. He borrowed in anticipation of future income from which repayment could be made, but he also borrowed when no definite future income was in sight. He always repaid the debts he incurred.

Siddiqi argued that the usual sources of revenue of meeting public expenditure during Prophet's time were the following:

1. Zakat (including ushr) which gradually grew in volume after the second year after hijrah when it was introduced.
2. Fai, including the product share from Khaibar which was a steady source of revenue.
3. Spoils of war out of which a share accrued to the public treasury.
4. Voluntary donations, often in response to appeal from the Prophet saw.

The first three sources brought nothing during the first year of the Prophet (saw) in Madinah, hence exclusive reliance must have been placed on the last. In the light of available reports, revenue from all these sources was meager till year seven when Khaibar was subdued. Some cases of small borrowing for need fulfillment seem to belong to this period. But as Siddiqi explained, the two cases of big borrowing belong to the post-Khaibar period and relate to defense purposes.

Siddiqi could not find a single instance of public borrowing during the reign of the Khulafa Rashidin (11-40 A.H.). This is not surprising, he argued, as revenues from zakat including ushr, fai including kharaj, as well as spoils of war were steadily rising throughout this period. These revenues would have been sufficient to meet all public expenditure including need fulfillment and defense.

Something similar applies to the next hundred years of Umayyad rule (41-132 A.H. / 661-749 A.D.). Siddiqi could not find any instance of state borrowing at the level of the central administration. However, Siddiqi noted that there are reports from the provinces of army commanders borrowing to equip their forces or governors borrowing to pay Ataya (salaries & pensions) on time, or in order to provide famine-relief. Similar phenomenon applies to the first century of Abbasid rule (132-232 A.H.) where was blessed by firm central administration and robust finances.

The first reports of public borrowing, as Siddiqi explained, appear during the reign of the eighteenth Abbasid Caliph Muqtadir (295-320 A.H./ 908-932 A.D.). Siddiqi reported nine cases relating to public borrowing where all belong to the period 300 - 333 A.H. This period was ruled by four Abbasid Caliphs, Muqtadir (295-320 A.H.), Qahir (320-322 A.H.), Radi (322-329 A.H.), and Muttaqi (329-333 A.H.).

CAUSES OF PUBLIC BORROWING BECOMING DEBT CRISIS

In contemporary muslim countries, public borrowing is being used excessively. Uthman precisely points out that one of the most cumbersome problems in the 1980's for many countries around the world has been how to reduce government budget deficits and mounting public debts without disturbing economic and social stability. The severe fiscal austerity measures taken by many European countries to meet the requirements of a monetary union before the end of this century have resulted in massive

unemployment in some of these countries. In 1990, Europe's unemployment was 7.9 percent. In 1998 it is 10 percent. (Newsweek, a special issue, Nov. 1998-Feb. 1999, p.20) Samuelson & Nordhaus (1995) explain that in the United States, the major unplanned increases in the budget deficit in the 1980's were health care (from 1.1 to 2.7 percent of GDP) and interest payments (from 1.8 to 3.4 percent of GDP). But why are deficits so bad?

Deficits affect the economy in the short run though their possible crowding out of private investment. The major point about a large deficit in the long run is that "it tends to reduce a nation's growth in potential output, because it displaces private capital, increases the [microeconomic] inefficiency from taxation [in terms of work and saving incentives] and forces a nation to service the external portions of the debt". Charles Schultz points out that large deficits have greatly impaired governments' abilities to consider new programs or substantially expand existing ones. [Samuelson & Nordhaus, 1995, pp. 630,631,628,639 respectively]. The problem in third world countries of weaker economic base, less developed financial markets, and heavy reliance on external debt is even worse. The Asian economies [both governments and firms] have suffered a financial crisis simply because there was a shortage of savings and foreign exchange.

The shortage was financed by financial debt that was denominated in foreign currencies. Things were made worse by the fact that these debts were short term for the most part. This implied that the payments schedules were de-coupled from actual production and sales. Had financing been done on a non-pure financial basis, the problems would have been much less acute.

INTERNAL FACTORS:

Excessive external borrowing. During the last two decades loans could be obtained at a negative real interest rate - that is the interest paid on dollar loans was less than the inflation

rate in the USA stimulated excessive borrowing. Much of the borrowing was at floating rather than fixed rates which caused problems later when interest moved up.

Poor choice of investment projects specially in those countries where the State rather than private sector made decisions often on political grounds. 'An expansion drive' characterized governmental behavior in many developing countries. There was a tendency to invest as much as possible without worrying about the costs, the quality or salability of the output. The result was an insatiable demand for inputs, including imports. Inadequacies of macroeconomic control. Domestic policies resulted in a rapid expansion of demand, outpacing the economy's supply potential. This led to a fast growth of imports, intensification of inflationary and diversion of resources to production for the domestic market. Anti-export bias of trade policies. Many debtor countries, especially those in Latin America and South Asia have pursued an extreme version of import substitution, whereas many East Asian countries favored export promotion. The result was the building up of high cost industries which have taken a great deal of imports to establish and to operate, while their output could not compete successfully in international markets, contributing to severe tensions in the balance of payments.

Overvalued exchange rates, which represented an added incentive to import and disincentive to export. Such exchange rates, combined with excessive government intervention and economic and political instability, created incentives for capital flight, aggravating the debt servicing problems specially in Latin America.

Rampant corruption in many Third World countries. As vividly described by Patricia Adams in her recent book 'Odious Debts; Loose Lending, Corruption and the Third World Elites', a large part of the Third World debt was contracted by illegitimate regimes not to improve their

nations' living standards but to funnel billions in their own pockets.

EXTERNAL FACTORS :

Excessive lending by commercial banks and governments led to excessive borrowing by debtors. Awash with OPEC petrodollars, western banks were not particularly selective about targeting LDC borrowers since they wished to divest themselves of excess liquidity. Governments were eager to lend to promote export. All too often, lending decisions by both are imprudent without carefully evaluating the borrower's capacity to repay.

Deteriorating terms of trade were an important factor responsible for the balance of payments difficulties of many less developed countries.

High interest rates partly because of a combination of expansionary fiscal and restrictive monetary policies in the USA, and partly because of the sudden realization by lenders of the risks inherent in loaning large sums to the developing countries.

Sluggish growth, trade imbalances and protectionism in the industrial countries. The large imbalances in the current accounts of Japan, Germany, and the USA also contributed to the lower growth in industrial countries, aggravated exchange rate instability and resulted in higher rates of interest and new protectionist measures in the United State.

SOME LESSONS FROM EARLY ISLAM FOR CONTEMPORARY DEBT ISSUES

Gulaid discusses at length about most of the instruments of fiscal policy conceived and implemented by the early Islamic state. Ibn Khaldun in his *al Muqaddimah* defined the function of the Islamic state as ensuring that religion belongs to Allah and that the word of Allah is supreme. Al

Mawardi defined the functions of the Islamic state as safeguarding religion and managing the worldly affairs of the Muslim.

Fiscal policy in Islam, therefore, is a tool among others, which, according to contemporary scholars, works to achieve the goals of shari'ah. While objectives of fiscal policy in Islam may be similar to those in a secular state, especially in so far as efficiency of resource allocation, distribution, etc. are concerned, the two systems differ somewhat in terms of the operational norms and the nature of the instruments adopted to achieve these goals. Meanwhile we can draw some lesson of contemporary relevance from this study.

1. Borrowing, when there is a need, is a legitimate activity even if it is from non-Muslims.
2. Fulfilling needs is one genuine reason justifying borrowing, while jihad is another.
3. While early history does not present any record of borrowing for financing economic development, it does provide an indirect justification of the same in an age in which economic development (especially of the third world countries) has become a sine qua non for need fulfillment as well as for defense.
4. Since the lender services receives no worldly return, public borrowing presumes the lender being motivated by moral and religious consideration. Projects directly related to jihad, those directed at feeding, clothing and housing the poor and providing medical care to those who can not buy the same, as well as educational and moral-spiritual orientation programs are most likely to motivate people to give qard hasan. The social authority should, therefore, make public borrowing purpose-specific and select purpose most likely to motivate lenders, in order to succeed in mobilizing interest free loans to the government.
5. State must repay what it borrows even if doing so necessitates further borrowing.