SELF RELIANCE AND ELIMINATION OF RIBA

ELIMINATION OF RIBA FROM THE ECONOMY

Institute of Policy Studies, PP 181-192 1994, 1995

Prof. Khurshid Ahmad

SELF-RELIANCE AND ELIMINATION OF RIBA

by Prof. Khurshid Ahmad

In December 1990, Prime Minister Mian Muhammad Nawaz Sharif appointed under my chairmanship a committee on national self-reliance. The committee produced its report within a period of three months. Formal presentation of the report took place in April 1991. After that, as usual, everything was put into cold storage. Repeated requests from my side and other quarters to at least publish the report remained without response. Non-publication of this report is a serious loss to the academic community, as in this report a serious and systematic effort has been made to spell out an alternate framework for economic development and policy-making. It makes a seasoned plea for the elimination of interest as a key factor in evolving an equity-based growth strategy.

I am seriously thinking of releasing this report in wider public interest. As a first step in this direction, I am taking this opportunity to share with you at least the basic approach and some of the suggestions of the self-reliance committee. What prompted me to do so was the frequent raising of the self-reliance issue in the seminar. The committee came to the conclusion that suspension of US aid could be a blessing in disguise. We realized that the aid-based developmental effort during the last four decades has not been able to produce the results that were expected of it, and there is an urgent need to scientifically and rigorously evaluate the net contribution of what the Third World countries in general and Pakistan in particular had been receiving in the name of aid.

Aid is a misnomer. There is only a small part which comes in the nature of a grant which can justifiably be called aid. The rest is either concessional loans or loans which are received more or less on market terms. The share of the latter is increasing in view of market-performance policies of the World Bank and other aid-giving agencies. As such not only the loan component of this alleged aid has been constantly increasing during the last two decades, the rates of interest on which these loans are advanced are approximately market rates of interest.

We realize that a large part of the aid is tied. It cannot be utilized according to one's own preferences, nor can it be used for purchasing the cheapest available supplies from the world. Instead, the donor country has a very substantial part of the commodities (or services) which it wants to sell at the price differential so large that in certain cases even up to 30 percent more than the other available commodities (or services) has to be paid.

Then there are other costs including transport, insurance, technical know-how. Once everything is taken into view, we discover that the net contribution is minimal. Currently around 70 percent of the "aid" received is directed towards loan-interest payment. The remaining 30 percent is the gross contribution; its net contribution is marginal. So it is only a trickle of contribution.

We also realize that the geopolitical situation has changed. It will be imprudent on our part to expect that whatever support and aid we were expecting or getting in the past could continue in the future. As such, we find that as a nation we have no option but to go self-reliant.

Doubtless we should have friendly relations with all countries, yet we must not remain dependent on aid. Ideologically also, we realize that one of the issues on which Islam is very sensitive is the independence, sovereignty and honor and self-respect of the Muslim Ummah. The Ummah is shuhadaa alannaas, and you cannot be a witness of Islam to the world if you are dependent on them economically, intellectually, technologically, scientifically and financially. Self-reliance seems the only way.

The Concept

What is self-reliance? We define it as a condition in which a nation makes free and voluntary choices in the disposition of its resources and output and in setting its economic and political priorities. This state of affairs is totally distinct from a situation where decision-making is constrained by a political or economic situation dictated by external compulsions. We made it very clear that self-reliance signifies the capacity and capability of the country to face any crisis on the basis of internal strength. This is only possible if the economy can maintain equilibrium on the basis of commercial transactions including trade and capital movement. In short, it implies self-confidence and the capacity for autonomous goal-setting and decision-making, rejecting dI forms of dependence, invited or imposed.

We, in the committee, developed this view and suggested that self-reliance does not mean self-sufficiency; no country can be totally self-sufficient. The committee does not equate self-reliance with self-sufficiency.

We also made it very clear that self-reliance does not mean isolationism or autarky; we are part of the world. We would maintain a network of relationships at all levels, including trade and capital movement.

We also emphasized that self-reliance is not a static concept; it is growth-oriented and dynamic. Yet it is very important that self-reliance must be our national objective. We also added that self-reliance is not exclusively an economic concept; it represents an approach to life and its problems.

Gradualism

The committee suggested a review of and revolution in the past approach of gradualism in achieving self-reliance. While self-reliance is not achievable overnight, there is a certain type of gradualism to which we have been addicted to and that has taken us nowhere. Look at the five-year plans, even the first plan says that within 25 years Pakistan would be self-financing; self-sustained growth was the term used. But where are we after 40 years of planning? More dependent than from where we started. This type of gradualism is not going to work. For that reason the committee suggested that a radical departure from the past was needed. It entails some

risk a calculated risk. Time has come that the nation should take this calculated risk. Make a decision; come up with a national commitment and harness all its economic, political, educational and information policies to achieve this objective.

What is the extent of our dependence on others? We probed this area quite thoroughly. It is not possible to go into all the details, yet we found alarming dependence on foreign aid and lack of self-reliance even in certain items of food, in oil, technology and defence production. That is why the key recommendation was that the nation should adopt self-reliance as a national covenant, the fundamental principle of the socioeconomic policy and the basis for individual life in the national context. That there should also be legislation on the subject, which we have described as a national self-reliance act. In fact, the committee has given a tentative draft of the self-reliance act as well.

Multi-Dimensional Approach

The programme we have suggested is multi-dimensional. One of the dimensions is that the government would have to launch a programme of curtailing conspicuous consumption and check non-developmental expenditure. A law should be enacted putting a ceiling on both budgetary deficit and deficit financing, because rhetoric apart, even blunt criticism from experts, economists and parliamentarians has not been able to deter the government from incurring reckless expenditure, deficits and deficit financing.

The present gigantic size of the government as well as all pervasive presence of the government in the country's economic life, has immensely contributed towards the dependence of the country on the outside world. An important element of committee's proposed strategy of self-reliance is a significant reduction in the size of the government. It needs to confine itself to:

- Protecting ideology, sovereignty and security of the nation;
- Protecting the rights of the weak and the underprivileged in the society; and
- Creating a congenial social and administrative environment for economic activities in the country.

The annual development plan would have to be totally restructured and many of its economic chapters would need to go to the private sector. Education, health and the social sector should be the primary concern of the annual plan.

We stressed that a privatization act would be required not only to give it a proper legal basis to provide for a more sustained and long-term policy but also to build into it the essential safeguards. We are not suggesting a total abdication of the government in the economic field; there should also be some corporatization away from the public sector proper corporations, accountable to the government and the parliament with built-in incentives, can ensure efficiency. (Out of over 154

units being examined by the Privatization Commission, only 10 have been running profitably, another 12 have been breaking even and the rest are running in losses over the years.)

A kind of decentralization was also suggested to transfer a number of functions from the centre to the provinces and from provinces to the local administration.

We carefully noted the recently-introduced reforms in the system of exchange and payments. Yet we felt that a foreign exchange regulation act was needed; we called it foreign exchange liberalization act. A draft of that was provided.

We also suggested a new, more powerful tariff commission and a new long-period tariff policy. This we thought was important because with industrialization in the private sector, the role of tariff commission would be very vital. So far the performance of the tariff commission has been disappointing.

We stressed the need of a thorough revamping of the taxation system because resource mobilization is not possible without a fundamental change in the taxation system.

The committee also suggested establishment of a public utilities commission under an act of the parliament to ensure that the consumer interests are safeguarded from the monopolistic price manipulations and other such influences.

The question of black-market economy was also addressed and it was concluded that tax system should be changed. The idea of a final whitening act was also examined.

Detailed proposals were given for critical sectors of the economy. On the issue of riba, the committee said a deadline must be fixed for total elimination of riba from the government sector.

Elimination of Riba

We concluded that movement towards self-reliance in our context was impossible without elimination of riba. As such our most revolutionary proposal was that a cutoff date be fixed for the elimination of riba, first from the domestic economy and then from external government dealings. This is the only point where we had some difference of opinion amongst the committee members. One group said that both dates should coincide while the other thought that the domestic economy could be cleansed of riba much more quickly and thus from the next budget, the domestic economy should be freed from riba. For external dealings, two years' time should be given. The 8th Five-Year Plan should not provide for any government or private sector loans based on riba.

As for the present debt burden, the committee was of the view, again I am not taking the Shariah sensitivity fully here, that because of the contractual responsibility of the government, let us take

the loans plus whatever interest or other obligations have accrued but at the cutoff point we would take a new figure and that figure would make the total debt liability. Then we will try to analyze it and see what its components are and how they can be discharged.

Individuals and governments are to be treated differently. Since the intergovernmental transactions are mere book transfers the interest should be written off altogether. For the rest, we have suggested that a mutual fund for debt liquidation should be created. We worked out that the total investment in public sector was presently about Rs 125-130 billion. The total assets are estimated to be about Rs 900 billion. Our total international and domestic debt comes to about Rs 850- 900 billion. We suggested that we start with domestic funds and whatever we get from the disinvestment of the public sector should go into the national debt-liquidation fund and then through a phased programme we would liquidate these debts.

Now the immediate impact would be that about Rs 70 billion worth of debt-servicing, a drain on the budgetary resources, would become available for other heads of expenditure. And if we can impose the discipline we are suggesting the future budgetary deficit can be restricted to the required limits. Meanwhile, we will be in a position to liquidate the entire debt burden over a period through the resources which have been made available in this form, without default and without revoking any of our commitments.

As far as the grants or nominal service-charge-based transfers are concerned, they do not fall within the ambit of interest; that door will remain open. But all other capital transfers should be either in the form of interest-free grants and loans or equity investments and venture-capital.

We found out that of the present debt, about 86 percent is owed to consortium countries (USA 23 percent, Japan 14 percent, West Germany 10 percent and multinational agencies 42 percent). We suggested, of course, that we examine the possibility of default also — and there are many countries which have done that — but we did not recommend it; instead, we suggested the idea of renegotiation and restructuring of the loans and that is what we have done in the past. In 1971-72, and then in late '70s, Pakistan has done that twice. And dozens of other countries have done that, too.

We suggested that there are many possibilities available for the international transactions. First, we realize that even in the western world there is an increasing realization that interest-based loans are becoming an unbearable burden for the Third World countries. Canada has already waived off all the interest. Australia has made a similar move. President Mitterrand of France has officially suggested in the Group-7 meeting that at least 30-50 percent of the present interest element of the debt should be waived off. So, debt remission is one possibility. It should be worked out both bilaterally and multilaterally. Other Third World countries should also be mobilized for this purpose.

We also suggested that debt-equity swap is one of the techniques that have been adopted successfully in a number of countries. It could be debt auctioning or negotiated conversion. It could

also be negotiations with creditors permitting them certain part of investment in national corporations and domestic investment, turning their debt into equity.

National Self-Reliance Fund

Creation of a national self-reliance fund in which contributions could be received from the people within the country and particularity from Pakistani expatriates was another major suggestion. We suggested that export of manpower as well as the resources of Pakistani expatriates should be utilized both for bringing venture capital in Pakistan and asking them to buy this debt by converting it into equity in national enterprises.

All these dimensions were examined and a workable package given within the framework of international law and understanding.

There is a need for a clear vision and the resolve that we are not going to go back, whatever the consequences, and preparing the nation for that through a comprehensive educational programme. We suggested a new educational corps directed towards preparing the nation for self-reliance. We also suggested specific projects and strategies in the fields of agriculture, energy, engineering, industry, exports, imports and defence industries.

Apprehensions — How True?

We came to the painful conclusion that we are victims of our own obsessions and apprehensions. We assume that if we adopt this path then everyone would turn his back on us; this by all means is an assumption. We do not realize that debt- based development and interest-based loans are not the only ways of economic cooperation between individuals, enterprises, corporations and governments.

I have a couple of things to assure you that once we are firm on self-reliance and have a clear programme, others would be prepared to negotiate and even cooperate with us. Let me quote from the IMF staff papers:

"Indeed it is readily apparent that the Islamic model of banking based on the principle of equity participation bears a striking resemblance to proposals made in the literature on the reform of the banking system in many countries. The Islamic system may well prove to be better suited to adjusting to shocks that result in banking crises and disruption on the payment mechanism of the country. In an equity-based system that excludes predetermined interest rate and does not guarantee the nominal value of deposits, shocks to asset positions are immediately absorbed by changes in the values of the share deposits held by the public in the banks. Therefore, the real value of assets and liabilities of banks in such a system will be equal at all points in time. In the more traditional banking system since the nominal value of deposits is fixed, such shocks can cause a diversion between real

assets and liabilities. It is not clear if this would be correct and how long the process would take."

Mohsin Khan, Staff Paper, vol 33, No 1, March 1986, p. 19.

Another quote from Prof Haus Alba'ch a leading German economist, who says that Islamic banks belong to the class of equity-participation banks

"They supply equity in the form of venture capital to investors whose share is their ingenuity and their labour. Secondly, they supply equity in the form of equity capital as participants in the type of project which in general has a majority shareholder. They may be ideally suited to meet the need for equity capital in developing countries where the business risk is particularly high as well as in the industrialized countries where the development of new processes and new projects involves high risk and requires large amount of venture capital."

Islamic Banking, proceedings of the Baden-Baden seminar, London

Also, your attention is drawn to the OECD study entitled Arab and Islamic Banks in which Prof Traute Wohlers-Scharf accepts that Islamic banks are not merely trying to give interest another name. Legal instruments, within the framework of Shariah, exist which permit profitability on a different, albeit Quranically acceptable basis. He concludes:

"Islamic banking is trying to develop the relationship between finance on one hand and industry and commerce on the other. This new relationship is the basis of the Islamic economic system being set up. Though Islamic principles have yet to be put to the test in the competitive environment of international finance, the two systems are similar in that they both strive for closer ties between financial intermediation and economic asset creation. Islamic banks could make a useful contribution to economic growth and development particularly in a situation of recession, stagflation and low-growth level because the core of their operation is oriented towards productive investment. All countries, both in the North and in the South, need more venture capital. Loan capital is available, particularly from industrialized countries but at high interest rates. However, even medium-scale entrepreneurs find it difficult to raise sufficient risk capital for expansion and innovation. This has acted as a brake on productivity and economic growth in the North. Thus practical and immediate cooperation possibility exists between Islamic banks and enterprises all over the world. The intermediation process remains to be fully developed."

Traute Wohlers-Scharf, Arab and Islamic Banks, OECD, Paris, 1983

And finally to put ourselves to shame let me also quote from an International Finance Corporation (IFC) report. On a proposed investment in the Hala Spinning Mills, the President of IFC and the World Bank observed:

"A change to Islamic modes of financing has been considered by IFC. This would be contrary to the Government of Pakistan's intentions on foreign loans. Adoption by a foreign lender of Islamic instruments could be construed as undermining the government's policy to exempt foreign lenders from this requirement."

Report No. IFC/P-887, dated Dec 22, 1987, to the board of directors, IFC

What a shame! Others are prepared to examine the possibilities of switchover to Islamic modes of financing and we are put off because we are not prepared to move in that direction. That is the real hurdle. The authority lacks the will and determination to move in this direction. That is why we need a leadership that is motivated enough to pursue this new path. There is no danger that they would flounder in wilderness. If a reasonable and economically viable arrangement is suggested to others, even to the West, we are sure, the response would be positive.