The existing specialized financial institutions attempting to mobilize human resources in various parts of the world seek guarantees of repayment of principle with return. Some of them, operating in very poor areas, have developed certain pressure groups to force borrowers to repay the principal with return irrespective of the outcome of their enterprise. People are put in jail for not repaying loans in order to ensure repayment. All this demobilizes even those human resources which may have productive potential but which may not have resources to repay the loan in case of the failure of an enterprise. The bulk of the human resources in labour abundant countries fall into this category.

It should also be noted that since, in the Islamic financial system, there is Zakah on wealth, wealth cannot be left unproductive, but must be invested to earn a return of at least 2.5 per cent to pay Zakah. If no interest-based option is available, people have to look for entrepreneurs to invest their resources. The private sector, therefore, mobilizes human resources to generate potential entrepreneurs who can invest their funds productively. It is only a matter of developing appropriate institutions to harness this potential of the private sector. There are examples in Muslim countries where some unscrupulous elements developed such institutions and mobilized millions of dollars of additional resources on the pretext of investing the resources on an Islamic basis of profit-sharing. However, not properly regulated and controlled by government, these institutions usurped the resources mobilized from small savers. But this experience did indicate the potential in Islamic societies to raise funds for entrepreneurs. On the other hand, what we are emphasizing is that, in the first instance, the proposed model has a built-in potential mechanism to create new entrepreneurs as new finances are mobilized and injected into the economy. This potential is to be exploited to mobilize not only idle human resources but also those who are presently working as fixed wage employees but who have the potential to be entrepreneurs, who will not only initiate new activities, but will also generate a greater demand for labour than the same amount of investment would have generated if it had been given to already established entrepreneurs. We only propose that this potential of the Islamic financial system be exploited through appropriate polices to accelerate and upgrade the employment of human resources in the economy (without affecting the rest of the growth and development targets of the economy) at a rate higher than what can be achieved by an interest-based system. In addition to this, we are proposing that special development financial institutions be established to reinforce the system by catering to the needs of the very poor through special arrangements. It will be shown below that with the Islamic financial system, these institutions are likely to be more effective than their counterparts in the interest-based economy. The strength of the argument for the model, however, is not in the success of such specialized institutions, but rather in the unique nature and potential of the entire financial system for human resources mobilization.

8. CONCLUSION

The Islamic financial system is more conducive to the mobilization of human resources in society. It is not being claimed that the Islamic financial system can automatically and miraculously mobilize all human resources. It is only being claimed that the system has the potential to support a carefully designed program to mobilize human resources. This claim is based on the following features of the system.

1. It has no built-in bias towards capital-intensive (labour saving) technology.
2. It sets the prices right to create more price incentive for human resource utilization.
3. Human resources are not intimidated by the fear of the loss of capital or by the fear of starvation for undertaking an enterprising activity, if they do not or cannot find a wage-paying job for themselves.
4. Public policies for growth and employment can be more effective because financial expansion comes mainly through generating productive activities.

In the presence of the Islamic financial system, a carefully designed human resources mobilization program can be more successfully launched by ensuring the following:

i) Tilting the financial system, as far as possible, towards using the participatory mode of financing.

ii) Adopting an approach towards human resources mobilization consistent with the features of the participating financing aspects of the Islamic financial system. This requires that human resources mobilization should not simply aim at creating (wage-paying) employment opportunities in the formal sector, but should rather pay more attention to the creation of activities in the self-employing/informal sector. The system not only attempts to create new opportunities in the formal sector, but is also conducive to upgrading existing activities in the informal sector to facilitate entry into the formal sector.

iii) Developing the institutions to support the financial system and the desired approach towards human resources mobilization. These institutions will aim at :

a) identifying small projects that can be taken up by people with little means;

b) motivating individuals/families to take up projects in order to best utilize their human capital;

c) arranging finances (on an Islamic basis) to support the acquisition and operation of projects;

d) developing financial instruments with specific aim of mobilizing human resources[9];

e) monitoring and guiding the performance of the projects.

In conclusion, it should also be mentioned that it may not be necessary to wait until the entire financial system is Islamized before the proposed program of human resources mobilization could be implemented. What can be done is to earmark substantial amounts of the financial resources of the country for investment on a participating basis with the unutilized human resources. But this can only be done in the public sector. The private sector, having the option of interest-based financing, will be unwilling to engage in participatory financing with people with little means. The advantage of Islamizing the entire financial system in society would be that even the private sector would contribute to human resources mobilization as the elimination of interest-based financing would remove all the incentive to finance large, capital-intensive enterprises.

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APPENDIX

ISLAMIC FINANCIAL SYSTEM

Briefly speaking, we are talking of a system with the following features :

(1) There is no interest in the economy. Financial capital can earn income only by bearing and sharing the risk of losses. All banks, commercial financial institutions and development financial institutions will seek and provide finances which will always have some risk bearing element. Although there can be several different ways (to be discussed in more detail later in this section), all of them must have some form of risk bearing by the finance supplier.

(2) If financial capital is not willing to bear and share risk, it can then be advanced on a *Qard Hasan* basis. In this case, financial capital neither earns any income nor bears or shares any risk of loss. Commercial financial institutions, of course, will not indulge in such transactions on a large scale. The system will develop special institutions for this type of financing, either on a cooperative basis or in the public sector.

(3) There are Zakah and charities in the system (the minimum obligatory levy being 2.5 per cent on the ownership of financial capital). Besides serving as a deterrent to keep financial capital idle, it also serves as obligation-free financial support to the low income section of population.

(4) Public borrowing is constrained by the absence of interest in the economy. Public borrowing will either come in the form of risk bearing capital for commercially productive projects or it will come in the form of *Qard Hasan* to the government. Government securities, which bear a return, can be issued only for such borrowing that is linked to commercially productive activities.

(5) In principle, it is possible for the government to print money, if its benefits outweigh its costs.

Within the above-mentioned outline, it will be instructive to go into more detail about the modes of financial accommodation in the above-mentioned system where interest is absent and financial capital can earn income only by bearing the risk of loss.

MODES OF FINANCIAL ACCOMMODATION

From Islamic teachings, we can identify two categories of permissible forms of financial accommodation. One can be called Direct Financial Accommodation and the other can be called Indirect Financial Accommodation.

DIRECT FINANCIAL ACCOMMODATION

Financial needs are allowed to be met by the finance owner in one of the following two ways: the *Qard-Hasan* System (QHS) and the Profit-Loss Sharing System (PLS). Under QHS, a finance owner may provide a loan to someone who needs it. He will have a claim only on the principal amount. He cannot claim any return on it, small or large, nominal or real, directly or indirectly. The finance owner, in this case, is also obliged to reschedule or postpone the repayment of the principal amount, if the borrower's conditions are such that he does not have the ability to pay. The postponement is required to be given until he is able to pay.

If a finance owner intends to benefit from his financial accommodation, then he will have to enter a PLS arrangement with a finance user in the context of a specific productive/commercial enterprise only. The PLS arrangement is not allowed if the financial accommodation is for consumption purpose or for general purpose (in which case the QHS is the only option).

The principle of PLS arrangement is the following. The finances will be provided for a specific project or productive activity. The finance provider and the finance user will agree to share the profit earned from the project according to a pre-agreed ratio. The profit- sharing ratio may be different from the ratio of the investments of the two parties in the project. In case of a loss, both parties will share the loss in the exact proportion of their investment in the project. The loss cannot be shared in a ratio different from that of their investment.

There is no other option for Direct Financial Accommodation.

INDIRECT FINANCIAL ACCOMMODATION

There are and can be several permissible Islamic ways of indirectly providing financial accommodation. Some of these are or have been in practice and others may be discovered or identified in the future. Before explaining some major forms of Indirect Financial Accommodation, let us first clarify the fundamental principle underlying these forms. The underlying principle which will always have to be adhered to in both Direct

Financial Accommodation and Indirect Financial Accommodation is that there can be no return earned on one's finances without subjecting these finances to bearing some part of the risk associated with the activity in which finances are being used. The only difference between Direct Financial Accommodation and Indirect Financial Accommodation from the point of view of risk bearing (if return is to be earned on financing) is that under Direct Financial Accommodation, risk bearing is in exact proportion to the investment of two parties and is for the entire period of the use of finances, whereas under Indirect Financial Accommodation, the risk bearing can be different from the proportion of the investments. Sometimes it may be possible for the finance provider to substantially reduce his part of the risk bearing (but he is not allowed to totally eliminate it) and it may also be possible to substantially reduce the period of risk bearing (though he cannot reduce it totally).

Let us briefly describe some major forms of Indirect Financial Accommodation. These forms can be described under three major categories, namely:

(i) Trading-based modes,
(ii) Leasing-based modes, and
(iii) Service-based modes.

TRADING-BASED MODES

There are two major forms of trading based modes: the Deferred Payment Form and the Deferred Delivery Form. To understand this concept, let us call the party needing the finance, A, and the party providing the finance, B.

Under the Deferred Payment Form, the permissible financing would be as below:

A needs financing to purchase certain goods. B is not interested in a PLS arrangement. B can offer to purchase the goods needed by A from the market. A will then repurchase them from B at a predetermined profit (mark-up on cost plus basis), and B will agree to receive the payment at some pre-agreed date. In this way, the financing needs of A have been met and B also ends up making a profit on his financing. The risk that B is bearing is that during the period he is marketing the goods for A and all the goods are delivered to A, the entire loss will be his. Furthermore, it is also possible that after B has made all the purchases for A, A may change his mind or may not like the goods marketed by B and, hence, B will end up with the responsibility of disposing of the goods purchased by him. This risk can, however, be further reduced if B appoints A, himself, as his (B's) agent to purchase the needed goods. In this case, of course, A will purchase the goods that he needs and the risk of rejection of goods is, thus, removed. The risk of loss or damage of these goods, however, will remain with B until A finally makes a contract to re-purchase them from B. Until A makes this contract, A also has the option to change his mind. Hence, some risk will still be there. Any attempt to eliminate the entire risk, for example, binding A to repurchase the goods from the beginning of entering into the deal will be against the spirit and fundamental principle of financial accommodation in Islam.

Under the Deferred Delivery Scheme, A approaches B to provide finances and B agrees to do so only by purchasing at a specific predetermined price certain specific goods that B will produce and/or deliver at specific date in the future. A's financing needs are met and B expects to earn a profit, because he contracted the price with some expected margin of profit. The risk bearing for B in this case is that he may not be able to realize the expected margin of profit that he had in mind while agreeing upon the price of the goods. The actual price at the time of the delivery of goods may turn out to be lower than what B paid in advance. Also B, after delivery of the goods, has to store and market them and in this process he bears several risks.

LEASING-BASED FINANCING

Leasing in itself is an alternative to financing. A needs equipment or real estate, but he does not have financing to purchase it. B uses his finances to purchase the equipment and leases it to A and charges rent on it. The needs of A are met. B makes a profit out of the rent.

It may seem that B is earning a fixed income without bearing any risk and, hence, that this is similar to interest. However, it should be noted that rent does not reflect a return on finance, at least in an Islamic sense. Under Islamic arrangements, B will be bearing the following risks while leasing the equipment to A:

(i) During the entire lease period, the maintenance of the leased item remains the responsibility of B. The total cost of maintenance during the entire life of the item will always be uncertain.

(ii) The leased item may be damaged or go out of order (due to no fault of the lessee) before repaying the total investment made on it and without realizing any return. Even if insured, the uncertainty of the working life of an item will make the gains from insurance uncertain. Under Islamic arrangements, passing on the insurance cost to the lessee will be against the principles of Islam. Finance leasing is, also, not permissible in Islam.

(iii) The lessor is not certain if the item will remain on lease at the expected rent long enough to repay him the investment and a certain return on it. All of this keeps the profit of the lessor on his investment on the leased item uncertain until the item completes its working life.

Leasing, however, is not financing and is only an alternative to financing. As mentioned above, leasing only met for A the need for using the equipment or real estate. But if A wanted to own the equipment or real estate and needed financing for this purpose, then leasing did not meet the financing need.

We have leasing-based financing modes which are modes of Indirect Financial Accommodation to meet financing needs in Islamic ways. The leasing-based modes work in the following way. A approaches B to finance a certain purchase. If the purchase is of a rentable good, then he may prefer to use the leasing-based mode. B makes the needed purchase and hands it over to A on lease. B also agrees to receive (in addition to rent) the payment of the price of the equipment, etc. in installments. As the installments of the price are paid, the rent of the equipment also declines proportionately. When all installments are paid, the rent to be received by B becomes zero, and the equipment is thereafter owned by A. The financing needs of A has been met as he ends up owning the equipment due to the financing from B. Also, B ends up receiving his investment, along with some return on it, in the form of the rent that he has received during the period.

SERVICE-BASED FINANCING

A is a skillful person and he can earn substantial income from his skill by producing certain goods. But he needs financing to purchase raw materials. The trade-based mode which allows for Deferred Payment is not suitable, because A is not a trader and does not know how to market his goods. The service- based financing mode can help meet financing needs of such a person. B offers A all the necessary materials to produce a certain amount of goods for B, and B offers to pay A on the basis of the completed output. A's financing needs have been met (and he is also relieved of marketing problems). B expects to make a profit by selling the goods, produced by A, in the market with some margin of profit. In a strict sense, this may not be called financing, but since it relieves the needy from seeking the financing to meet his needs, it can at least be treated as quasi-financing.

NOTES

1. The topic was specifically discussed in the Second International Conference on Islamic Economics held in Islamabad in 1986 and also in the Seminar on the Development of Financial Instruments held in Kuala Lumpur in the same year. Some writings that touch upon the subject include; M. A. Mannan [22], M. N. Siddiqi [25] and M. Fahim Khan [18].
2. For further discussion of this phenomenon, see Henry Bruton [6, 5] and Fahim Khan [17].
3. For further discussion of this point, see: M. P. Todaro [27].
4. See: H. J. Bruton [5] p.54.
5. See: David Morawetz [23].
6. See: Todaro [27] pp. 314-315.
7. See S. U. Sethuraman, *The Urban Informal Sector in Developing Countries*, ILO, Geneva, 1981.
8. For more discussion, see: Todaro [27] pp. 251-253.
9. Mannan, in Ariff and Mannan [32] referred to such instruments as Human Capital Certificates. Although the concept, as presented by Mannan, involves some *Shari'ah* reservations, it does point to an area for consideration and research. Further details on this can be seen in the proceedings of the Seminar on "Developing a System of Financial Instruments" held in Kuala Lumpur in 1986, edited by M. Ariff and M. A. Mannan and published by IRTI (see p.97).