

ALTERNATIVE ECONOMIES AND ALLOCATION OF INVESTMENT IN GLOBAL MARKETS: THE ISLAMIC ECONOMIC PERSPECTIVES

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Abstract

The current economic and financial crisis all over the world attracted the attention of investors and other stakeholders alike on what alternative economy can solve and set mankind free from the wrath of economic mess. History showed how the socialist economy of Russia failed woefully, leading to disintegration of United Soviet socialist Republic of Russia, the communist economy of china is also facing the same fate taking into consideration the continuous changes adopted by the authority to save the face of the economy from collapsing. The current financial crisis in Europe with particular reference to Spain and the nationalization of economic interest in United States are all indications of failures of capitalist economy, which affect investment. The objective of the paper is to assess Islamic system as alternative economy that can provide lasting solutions to investment and economics problems. In achieving the said objective, secondary data was employed, and the study found that the genesis of the failure of capitalist, socialist and mix economies is the hand work of a man. Interest is also another evil, which man himself consider as worst of all evils. The study recommended that Islamic economic system should be employed at all level of economic activities.

Key words: *Command economy, free market economy, mixed economy, Islamic economic system, investment.*

INTRODUCTION

The crisis in the global economic sector as a result of the failure of the major world economic system leads to a loss of millions of dollars, especially in investments and other allied practices. The financial practices in capitalist economy in banks, financial institutions and corporate bodies suffered a lot of criticisms both from philosophers, economists, religious teaching as well as from evidences on the grounds showing, the weaknesses and wickedness of this man- made economies. Part of this wickedness is dealing in transactions involving interests, which are the major financial practices playing a major role in western capitalist economy as argued by Suleiman (2002).

Investment in non marketable securities, and marketable securities (treasury bills, time deposit, call money) involves interest rate the fact is the same in fixed income security. Similarly, long term investments in form of capital budgeting decision are based on interest rates, which are used to discount cash flows.

The Islamic economic system as opposed to other alternative system does not recognize the existence of not only interest, but also opposes speculative activities, adulteration and investment in production of unlawful products (liquor, narcotics). Islam provides alternative investment and finance avenues in a form of Mudarabah, Mushalaka, Ijarah and Sukuk.

LITERATURE REVIEW

Alternative economies

The word economy has its origin from Greek word meaning one who manages a house hold (Mankiw, Kneeborne, Mackenzie and Rowe 2007), under the state of scarcity, where the person in charge faces many challenging economic decisions, as what to allocate, to whom, when, where and how to make the allocations of scarce resources to the society is what brought the issue of alternative system that a particular society will adopt to meet its desired needs. Morris, (1996) provide a clue on how to answer the above general questions, where he argued that, whatever decision is to be taken, the answer should comply with the way people think, perceive and belief is what constitute the alternative economies.

Mankiw, et al (2002) argued on two alternative economies, centrally planned economy and market economy. The planned economy allows the government to plan and organize economic activities that will meet and promote the economic well being of the society in general. In market economy, however, private hands replace the power of the government in determining, what, how and for whom to produce. This means market mechanism (price) supported by the forces of demand and supply played a vital role in capitalist economy.

To conquer with the view of Mankiw (2000), Chaudhary (1999) wrote that “the most dominant economic systems of the world in the present century are capitalism and socialism. Capitalism (free market economy) is based on the private ownership of the means of production, distribution and exchange. In capitalist economy, the profit motive constitute the prime stimulus to productive execution and the price mechanism determines what things shall be made and in what quantities and what condition”, he further differentiate socialism as an economy with believes in the public or state ownership of means of production distribution and exchange.

In similar development Miller (2004), identifies two alternative economies open and closed economy; most economies are open, dictated by market forces, which allows exportation, importations as well as trading both in assets and currencies. The closed economy on the other hand opposed the use of market mechanism, in production, distribution and exchange.

Wikipedia (undated) listed eight alternative economies which includes, capitalism, socialism/communism and mixed economy as major economies. Others include command, traditional, participatory, gift and barter economy. Dictionary.Com (un dated) traces both capitalism and socialism as a major competing economic system that coined around the past two centuries for instance capitalism originating from the world capital was formed to describe the emerging economies of the west and socialism dominates the then eastern blocks.

Furthermore, to meet the failure of both capitalism, socialism and mixed economy as an alternative economies, Suleiman (2002) and Kababji (2007) opposes the un fair treatment of the capitalist, socialist and mixed economy (ies) in wealth distribution, there-by making the rich or those at the helm of state affairs to become richer and poor left to be subjected to poverty, malnutrition, squalor and diseases. They proposed therefore Islamic economic system as the best alternative economy that will bail out the entire humanity from current dispensation (world financial and economic crisis) through ensuring fair and equitable distribution of wealth among mankind.

Alternatives Economies Systems

Capitalism

Capitalism as a system uses market mechanism to maximize profit. Profit maximization is the sole objective of capitalist economy decision regarding production and investment are determined by competitive forces in the market. The means of production is owned by private hands, who are motivated by the desire to make huge profits at the expense of others. Usually, interest, gambling and production of alcoholic and other narcotics substances, cheating and deceptions are all means to make a living in capitalist economy.

Among some of the features of capitalist economy, Kababji (2005) identify that the economy is characterized by private ownership of means of production, with unrestricted economic freedom. In the same token, Chaudhry (1999) added other features of capitalist economy to include; unrestricted private ownership, profit motive, competition and institution of interest. Capitalism as an alternative economic system, suffered a series of criticisms, starting from concentration of power, employment and capital on the hands of a very few, to exploitation in form of expropriation of labor for profit, forced labor, economic inequality as well as the payment of minimum wages instead of maximum wages.

Ponnani (2012) also criticized the capitalist economy, as interest based economy has brought in huge disparities between the rich and the poor. Similarly the system is criticized by inefficiency and waste as well as tendencies of inducing planned obsolescence by designing products that will not last long as to create new demands (Heather, 2001).

To expatiate further, Sun (2012) Vehemently opposes the performance of capitalist system as an alternative economy, by showing that capitalist model of resource and labor management is unfair, environmentally unsound, inefficient and unsustainable, and concluded by saying people who do little or does not participate in creation of wealth are the ones taking the whole share of the national cake.

Socialism

Socialism is a system, which is commanded by state ownership of the means of production and distribution. Production and distribution as well as investment are carried out through collective decision making by the state apparatus. Kababji (1999) view socialism as a system, which believes in the public or state ownership of means of production, distribution and exchange. The system denies economic freedom, disowns right to private property and claims to achieve economic equality. The central focus of socialist economy is to foster production aimed at satisfying human needs as opposed to profit maximization instituted by capitalist economy.

The major features of socialism as an alternative economy as observed by Kababji (1999) includes; state ownership of means of production, non – existence of private property, centrally planned economy as well as establishment of totalitarian state under dictatorship of protectorate. Similar to capitalism a lot of critiques, hammered the doctrines of socialism on many grounds for example Perry (2005) consider the whole idea of socialism as full with illusion and rhetoric, as it failed to provide what it promises and instead it leads to poverty, misery and tyranny.

Mixed economy

Wikipedia (undated) the free encyclopedia looks at mixed economies as economic system that contains substantial state, private, and sometimes cooperative ownership and operated in mixed economies. Alvin (2012) criticizes the doctrines of mixed economy on the following grounds; mixed economy trigger corruption as well as making those at the helm of the state affairs to enjoy certain privileges at the expense of the citizens. The system also failed to bring efficiency into the market, neither remove nor reduce poverty within the society. Similarly the system end up in most instances moving to closed economy in disguise, making it difficult to reap the benefit of globalization and international trade.

Islamic Economic System

The recent global economic crises coupled with market failure has provoked many to think for alternative (Huchsch, 2009) moving towards socialism and abandoning some of the free market ideal. This thinking suffered severe challenges, especially looking how the Russian socialist economy died unnatural death as well as how the economy of communist republic of China is witnessing changes.

Sulaiman (2002), Kababji (2007); Hamidullah (un dated) and Chaudhry (1999) argues that there is no any alternative economies to correct the mess of current economic and financial crisis than to adopt the teaching of Islamic economic system. Islam as a complete way of life has provided guideline and rules for every human endeavor, starting from economic, social, political and religious issues.

The fundamental sources of Islam are the Quran and the sayings of his prophet (sunnah) these two sources provides mankind with guidelines for economic behavior and a blue print on how the economic system of a society should be organized (Islamreligion.Com. 2011). This means values and objective of Islamic economic system must be in conformity with shariah. Shariah is a guidance of human activities, which encompasses, spiritual, social, political, cultural and economic well being. The unique features of Islamic economic system according to Kabbji (2007) is based on productive economy, and justice (Hamidullah) where there is no room for usury, speculative activities, cheating or man-made inflation, and these includes;

Productive base, production refers to the combining inputs to output resulting into finished products or adding value to available products or moving products from one end to another. The holy Quran permits production in various chapters. In Al nisai (4: 29) Allah said “Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent and do not kill yourself”. In another verse “ Where Allah has permitted selling and forbidden riba” (Al Baqarah 2:275). In production the principle of Islamic economic system emphasizes on mutual consent between the two parties as well as adaptation of principle of environmental mischief as well as prohibition of illegal products (Liquor, fork and gambling).

Prohibition of usury, usury refer to any direct or indirect return from lending (interest rate commission or charges). The Quran says “those who eat riba will not stand except like the standing of person between satan leading him to insanity. That is because the say “selling is only like alba where Allah has permitted selling and forbidden Riba “(AL Baqarah 2: 275).

Prohibition of speculative activities, speculation refers to a situation where purchases are made now with future anticipation in the rise of price. Islamic economic system did not spare room for speculative activities in Al- maidah, (5:90) Allah says “ and Maisi and arrows for seeking luck are an abomination of Satan hard work, so avoid that’ speculation in financial markets, real estate as well as commodities and shares interfere with natural market system, so avoid it.

Prohibition of cheating, Islamic economic system prohibited cheating in whatever forms, the Quran said in Al-Aaraf (7:56) “and do not do mischief on earth after it has been set in order” to this extent Islamic economic system prohibited fixing of prices, monopoly, prohibition of greed (weighting) and prohibition of payment of tax (taxes on products, income tax, sales tax as well as other indirect taxes imposes on people.

ALTERNATIVE INVESTMENTS IN GLOBAL MARKET

An investment can be defined as an allocation of existing resources to economic activities with the hopes of getting return (Suluiman, 2002). To look at the term in a broader term, Prasanna (2002) look at investment as a sacrifice of current money or other resources for future benefits.

Pandey (2005) identified three steps involved in the evaluation of an investment, which includes (i) Estimation of cash flows (ii) Application of decision rule for making decision and above all (iii) the required rate of return used to assess the investment projects. These take the form of discounted cash flow methods including Net Present Value, Internal Rate Of Return and Profitability Index, or the non discounted cash flow method criteria, which include the Pay Back Period and Accounting Rate of Return.

Investment alternatives, refers to the range of investments available at the disposal of investors. Prasanna (2002) classified the range of the alternatives into two major classifications investment in financial assets and investment in real assets. Investment in financial assets is sub-divided into non marketable financial assets, which includes; bank deposits, post office deposits, National saving scheme as well as company deposits. On the other hand marketable financial assets are also divided into money market instruments, (treasury bills, certificate of deposit and commercial papers). Investment in fixed income securities and equity common stock constituted part of the capital market instruments available for investors.

Investment in real assets, these constitutes investments in low liquidity investment, because of relative difficulty in buying and selling them. These investments include real states, precious objects and financial derivatives (Suleiman 2002, Prasanna 2002). In choosing alternative investments especially at global level the following factors has to be taken into consideration as advance by Yahaya (2012).

1. **Understanding the global investment prospects of the company**, who are the owners, what are the vision and mission of the organization, strength and position occupied by the organization at global scene.
2. **The rating of the company in the global market index**, Determining if the investment is rated excellent, good or poor, taking into consideration, the risk return relationship, and the ability of debtors to meet obligations when due.

3. Another important factor considers is the **effect of exchange rate** on local currencies, what is the current exchange rate against local currencies (dollar, pound or Euro).
4. **Diversification and globalization of the company**, Do the company has conglomerate businesses or makes forward or backward integration, what is the level of business of acceptance at global market, are some of the questions investors needs to know.
5. **Establishment of risk- return relationship**, another factor is trying to understand the risk return relationship of a particular investment proposal via determination of rate of return or discounting rate.

Alternative Investment in Islamic Economic System.

Islam as a complete way of life has provide and approved financing technique, which are shariah compliance and these includes in the following as provided by Sulaiman (2002).

- Qard Hassan, a benevolence loan, which is interest free loan and the amount borrowed, is returned on the date agreed upon by both practices.
- Mudarabah, is a financing technique, where the owner of the capital provides funds to the beneficiary on a profit sharing basis.
- Musharakah, this is when both parties, contribute equal some, or based on ability to establish a business on the condition that profit and loss will be shared based on agreed terms.
- Other modes of financing business are Ijarah (Assets leasing) in form of hire purchase and murabahah, a situation where beneficiary will put a request on Islamic bank to purchase an asset before selling him at a mark- up profit.
- Sukuk instrument is an Islamic portfolio approach which is characterized by return driven and paying less attention to risk and liquidity profile. It is an instruments and risk parity approach to asset allocation (Mauri, 2012).

Research Methodology

The methodology adopted for this study is an explanatory research, the study used this method to explain alternative economies viz-a- viz alternative investments. Secondary data was collected and used for the above mentioned purpose.

Findings

The method use in evaluating alternatives investments in western capitalist economy are faulty and un ethical, the discounted flow methods depend on interest (rate of return, discounted rate on required rate of return) and this interest rate issue is considered as the worst of all evils.

The study found that, interest was criticized, and condemned by Religious bodies (Quran 2: 275 and 3:130 Psalm 15:5; Ezekiel 18:8, Hebrew; Exodus 22:24, Deuteronomy 23:20-21) philosophers and economists. Plato and Aristotle were against interest, for instance in his Laws book v he wite and condemned interest, similarly Aristotle in his work the Politics, chapter 10 book 1 did the same(Quraish, 1967 in Suleiman, 2002). In his work The General Theory of Employment, Interest and Money, Keynes as reported in Sulaiman (2002) was not only against charging high interest rate but he recommended that interest rate should be closer to zero.

The study found that capitalist economy, which constitute majority of the world economy depends purely on interest rate, and cannot provide answers to economic problems and the socialist economy failed and the communist economy is facing similar fate, taking into consideration the major changes that is taking place in communist republic of China.

It is also noticed that alternative investment. Under the capitalist economy rooted in interest rate as determining factors of making investment allocations. This is what increases the rate of volatility and increase in the rate of investment failures.

Excessive trade liberalization and freedom, The study found that there is an excessive freedom on what to produce or what to sale, the limiting factor is the amount of capital not morality or religious injunctions.

Summary

The world witnesses how the major alternative economies failed to provide basic answers to economic problems. All the theories were built on rhetoric and fallacy, which shows the weakness of human thinking in challenging what the supreme being endorsed as a guidance to mankind. Islamic economic systems pre-dates Adam Smith and his work (the wealth of nation), it also predates Karl Marx and his deception in Das Kapital. The capitalist themselves agreed that the capitalist economy cannot take them to anywhere, the socialist economy is died and the communist economy is facing serious challenges in addressing its economic problem. The Islamic economic system via its financing technique will provide equity and justice in terms of wealth distribution to everybody.

Recommendations

To have a vibrant economy and free conducive atmosphere for investment allocation at global level, the study recommended the followings.

Alternative investment appraisal techniques, both discounted cash flow methods and traditional method should be abandoned, a return-driven formular should be employed.

Since interest was criticized and condemned by, religious bodies, philosophers and economists the paper is recommending that, interest rate should be phased out completely from economic literatures.

The study is recommending that since the major alternative economies failed to bring out the world economy from present predicament, the paper is recommending the abandonment the failed economies and call for the adaptation of Islamic economic system as the last alternative.

The paper is recommending for investors to invest in a shariah compliance instruments (sukuk) and adopt other financing techniques, such as Ijarah, Madarabah, and Musharakah as opposed to investment in marketable or non marketable securities, fixed income securities and derivatives.

The paper is recommending that, there should be a limitation to excessive freedom in trade and production, and this should be guided by what is known to be lawfully, as well as what will morally fit into the society.

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