Q: If interest is fully abolished, what would be the inducements in an Islamic Economic System to provide incentives for saving and for economising the use of capital?

A: It is very well recognised that interest is not the primary or otherwise an important factor for the saving. The overall savings in the economy primarily depend upon the level of income. Some of the basic motivating factors for saving are:

a) meeting future exigencies,

b) providing for old age, and,

c) bequests.

Since these factors will remain even after the elimination of interest, therefore, it is most likely that the overall rate or level of saving will not be affected significantly (after the abolition of Riba from the economy).

Muslim economists have suggested a wide range of saving instruments which will be available to the potential savers in an interest free economy.' These instruments vary in terms of liquidity, risks and returns so as to match preferences of the savers. Apart from existing profit-based instruments like shares of joint stock company, N.I.T. Units, ICP Mutual Funds and Investors Deposit Account and Participation Term Certificate, new saving instruments compatible with Shariah, can be brought into being. Among them, Mudarbah bonds floated by the Government as well as by the private concerns can play important role. Similarly, a variable dividend security issued by the State Bank can serve as an important instrument. The holders of this security will participate in its profits. This will provide a low risk medium of investment for the private investors. Also, it can serve as a substitute for Government Bonds and Treasury Bills for Investment of the surplus funds of the banks and other financial institutions.

Lastly, the Government Bonds bearing no interest can be issued when the holders may enjoy tax concessions.

As regards the role of interest as a discounting factor, it is pointed out that even in the Western countries, the pure rate of interest is considered to be an inadequate measure as a discount factor. It is usually adjusted for a risk-premium.

In an Islamic Economy, the rate of return on real investment can play the role of discount factor. Practically, it can be approximated by the return on NIT Units.

Contemporary fatawaa