

An Islamic Approach to Economics

Muhammad Najatullah Siddiqi

Introduction

This paper begins with a brief look at the development of economics through the last two centuries, focusing on the major methodological approaches, although we have something to say about the earlier periods also to set the perspective right. We try to identify the issues which engaged the attention of the masters of the discipline and the problems facing man and society that engaged their attention. We note in this regard the gradual ascendancy of formalism in economic theory and the meaning and purpose of economics gradually yielding ground to tools and techniques of analysis. This would bring us to the second quarter of the twentieth century when economics was again forced to come face to face with reality and a methodological crisis ensued. We shall note the contemporary content of economics and the various methodological approaches before we pass on to the next part of the paper which deals with its major theme: *relevance of Islam to our discipline*. It is argued that the Islamic tradition in economics has always been free of formalism, focusing on meaning and purpose with a flexible methodology. This suits the multi-dimensional concern of Divine guidance with man and society. Economics must be open to contributions from other disciplines and both science and art must join hands to realize, in economic affairs, the Islamic vision of good life. Contemporary Islamic economic thought is an extension of this well established tradition. We try to elaborate upon the nature and scope of Islamic economics by evolving a framework designed to accommodate its contemporary content and capability of explaining its development through history. This would bring us to the third and the last part of our paper which reviews the progress of Islamic economics in behavioral analysis, policy studies, and system building. This account of the current state of the art, examined in the context of the current state of conventional economic theory and policy, provides an opportunity for making some suggestions on priorities for research in Islamic Economics as a program for the future.

I. History and Method of Economics

A. Early Economic Thought

The thinking man has always paid attention to economic matters: poverty and riches; barter, money and trade, price fluctuations, taxes and interference by the rulers. Sometimes they also pondered over rise and fall of civilizations, accompanied by prosperity and economic backwardness. In doing so, they described as well as prescribed. They were, generally speaking, not bound by any particular method though induction may be regarded as the more popular one. During the periods when large populations were inspired by one of the great religions, namely Hinduism, Buddhism, Judaism, Christianity or Islam, scriptural injunctions and religious law dictated policies or recommended approaches which were interpreted and debated by scholars providing fresh food for thought. This applies even to the devices for circumventing some of the prohibitions like that of interest. But the religious inspiration accounted for much more than that in the evolution of economic thought. It provided a point of reference for well meaning critiques of social institutions, the rulers and the dominant classes of society.

This was the situation, broadly speaking, till Adam Smith and the birth of 'classical' economics. Mercantilism, the strand of thought preceding the classical school, was devoid of the tendency to abstract generalize or to deduce *a priori* notions about human behaviour. The Mercantilist writers did not construct imaginary models nor did they strive after discovery of universal laws. They were practical people thinking and writing like participants in a process designed to realize certain ends. It never occurred to them to pose as spectators interested in giving a detached positive analysis of the reality they observed.

B. Classical Economics

Adam Smith's *Wealth of Nations*, published in 1189 AH/1776 AC, has rightly been credited with ushering in a new era in economics. Smith still shared many of the characteristics of the earlier periods, his economics being a part of a system of morality. He was concerned with the ends, the purpose, the ethical values of the society and was not averse to shaping them.¹ But the desire to abstract, generalize and arrive at universal laws had its own demands. He

¹ Piero V. Mini, *Philosophy and Economics: The Origin and Development of Economic Theory*, (The University Press of Florida, Gainesville, 1974), p. 64.

postulated “a logical system of economic relationships based on an underlying law of human nature (analogous to Newton’s law of gravity).”² The essence of this law was self-interest, which ensured order in the apparent chaos of the exchange economy appeared to be and also propelled the system towards growth. The individual, as consumer, appeared as the chief actor on the economic scene since his wish was realized by the market mechanism. Any interference from any quarter, especially from the government, was bound to disturb the perfectly harmonious operation of the system which promised to maximize the social good through maximizing the individual good. Thus he ‘provided moral defence and a scientific blueprint for the market exchange system.’³ Smith had many a disparaging aside on the traders and the capitalists but the self propelling system seemed to him to be too powerful either to admit a need for social coercion to thwart their manoeuvre or to assign them—or to investment as such—as prominent a role in the system as he assigned to the consumers and their demand. The heart of his economics was the theory of value of which he considered labor to be the essence. Applied to capital (goods) this posed a serious problem with which Ricardo, the second architect of the classical economics, was to grapple throughout his life, only to conclude that relative value was affected not only by labor but also by the rate of profit, which had nothing to do with it. “After all, the great question of rent, wages and profits must be explained by the proportions in which the whole produce is divided between landlords, capitalists and laborers and which are not essentially connected with the doctrine of value, he said.”⁴ Ricardo added much to the rigor of economic analysis, carried abstraction to a level higher than that found in Smith and showed a far greater predilection to logical reasoning from *a priori* axioms and demonstrated the determination of economic variables by economic variables. He had little use for Smith’s deep insights into a reality which was far too complex to admit such rigor and ruthless enough to allow ‘experience’ or ‘observation’ to deter him from the logical conclusions to which his Cartesian methodology led him. But his preoccupation that the ‘laws of distribution’ led the future course of economic theory, in both its Marxian and Marginalist versions, to envision a composite theory of value and distribution which was henceforth to form the core of economics for more than a century.

But before we pass on to Marx or the Marginalists, a brief mention is due to the Historical School which originated in Germany. Though it failed to change the course of mainstream economics, it did serve as a caution against

² Phyllis Dean, *The Evolution of Economic Ideas*, (London and New York, Cambridge University Press, 1978), p. 11.

³ E. Ray Canterbury, *The Making of Economics*, (Belmont, California, Wadsworth Company Inc., 1976), p. 5.

⁴ From a letter of David Ricardo to J. R. McCulloch, quoted by Piero V. Mini, *op. cit.*, p. 95.

sweeping generalization and abstract laws and concepts of the classical economics.

C. Marxism

We do not propose to devote much space to Marx either, not because we deny him the place he has in the history of modern thought in general and of economic thought in particular, but only because time and space force us to economize and concentrate on mainstream economics which developed through the Marginalists into neoclassicism till we reach the age dominated by Keynes. Suffice it to note that the economics of Karl Marx was based on an epistemology different from the Cartesian theory of knowledge and being which inspired the classicists. He was inspired by Hegel, but he proceeded by 'turning Hegel right side up again'.⁵ 'Marx's theory of knowledge is empirical and historical from beginning to end'⁶ and his economics closely follows his philosophy of history. But despite its roots in the world of matter his philosophy deals very much in concepts and abstractions, sharing the heritage of the classicists and often being counted as one among them. Nevertheless, his was a totally different paradigm being "focused on the failure of orthodox political economy to prescribe for a desirable *distribution* of wealth."⁷ This is the one thing that stands out from the tough and rough texts that Marx and his followers contributed to economics and the feature which still continues to attract many adherents to his system, adherents who may share neither his epistemology nor his philosophy of history.

To note another significant departure: Whereas in the classical scheme, the ideal obtained of necessity, only if the world was left uncontaminated by human interference, but for Marx the ideal must clearly be recognized and fought for. 'This activism distinguished Marx from Hegel as well as from orthodox economists'⁸ and reinforces the capacity of his system to attract socially concerned citizens.

D. Marginalism

The Marginalist revolution in economics related to the formal aspect of the analysis and not to any new vision of solving man's economic problems. All objects of desire were reduced to a common denominator, utility, which allowed for increase or decrease in infinitesimally small amounts to permit the application of differential calculus. Consumption goods were, of course, available

⁵ Piero V. Mini, op. cit., p. 174.

⁶ Ibid., p. 177.

⁷ Phyllis Dean, op. cit., p. 16.

⁸ Piero V. Mini, op. cit., p. 167.

only in units of a given size and value but the demands of the method were supreme, hence the assumption of perfect divisibility. Later the same method was applied to factors of production whose employment we assumed capable of being increased or decreased in small amounts and substitutable one for other, on the margin. The rational consumer had all the knowledge he required for a choice among the myriad options so as to equate utility on the margin and, thence, maximize it. The same applied to the producer who substituted one factor for another till the marginal productivities were equal all along the line. All the real world hurdles of indivisibility, heterogeneity, rigidity in production functions and basic qualitative differences between various units of labor, and between labor and capital, etc., were brushed aside to perfect a technique which afforded the rational maximizer unhindered operation in a perfectly competitive world where all concerned had all the knowledge. The results were wonderful indeed: Maximum satisfaction to the consumers, maximum profits for the producers, optimum allocation of social resources with regards to distribution, the system ensured for each, a reward equal for his contribution to the joint product, factor prices being equal to marginal productivities.

More than half a century following J. S. Mill (1232-1291 / 1816-1873) – whose *Principles of Political Economy* was the last of the classical contributions which still had deep roots in the complex reality that was the economy of man – was required to achieve the perfection of this methodology. Jevons, Menger, Wieser, Walras, Bohm Bawerk and Clark were thus able to dethrone the cost of production theory and enthrone the subjective theory of value and distribution. Henceforth it was clear, in the words of Wieser that ‘The theory takes its point of departure from within, from the minds of the economic man.’⁹ What mattered was the method. All that defied this method was simply abstracted away. Since the system itself ensured perfection, there was simply no room for policy. The only policy prescription that could emerge was to let things have their way unhindered by any interference.

E. Neoclassical Economics

Reviving the Smithian style of frequent references to social reality and reliance on analogies where deduction might fail, Alfred Marshall (1258-1342 AH / 842-1924 AC) assimilated Marginalism into the classical framework, reinterpreted the latter where necessary, and reinforced the theory of value and distribution by introducing the famous cross of demand and supply curves and analyzing in detail the various types of equilibria. The neo-classical school

⁹ Quoted by Piero V. Mini, op. cit., p. 105

in economics symbolized the ultimate triumph of free enterprise Capitalism against its socialist detractors. The triumph of method over meaning, of means over purpose and of formal analysis over the content of what was being analyzed was now complete. The very debate on positive versus normative nature of economics indicates this triumph. Such a controversy did not arise a century earlier when analysis was a means to increase man's ability to manage his economy, not an end in itself. For this is what positive economics amounted to; its only social relevance was its ability to assure that what is, also ought to be. The analytical insights the neo-classical economics had to offer related to an imaginary world of perfect competition and perfect knowledge in which marginal techniques of analysis demonstrated maximization of utility and output, and the solution of the central economic problem as conceived by it, i.e., allocation of scarce resources. Neither time nor space disturbed this analysis, not to speak of the variety in culture and tradition and other features distinguishing man from man, society from society, region from region and one historical epoch from another. All these were irrelevant for the universal categories with which the system dealt.

One should not conclude that economists did not talk about anything other than the theory of value and distribution. They did discuss money but only as a *numeraire*, (because the marginal calculus could deal only with numbers not with speculation and expectation). International trade was taken care of by the assumption of perfect mobility and the real world complexities were confronted with only one option: free trade growth and development were concepts foreign to a system which envisioned maximization of production with optimum allocation of resources and which, having abstracted away time, as well as uncertainty, could not admit technological change in any real sense. Public finance could hardly deserve any notice in a regime of *laissez faire*. Labor and industrial relations could deal only with the pointlessness of any resort to unionism. What else is left?

Marshall's *Principles* was the standard text in economics even beyond the first quarter of the twentieth century. But already new and disturbing thoughts were surfacing. Schumpeter's characterization of the entrepreneur and Knight's insights into the all-pervading uncertainty, hardly fit into the neo-classical wonder world. Flaws into the neo-classical theory of value (and distribution) appeared as the perfectly competitive equilibrium and a remainderless distribution of product were shown to depend on the assumption of constant returns to scale. The work of Piero Sraffa followed by those of Joan Robinson and Chamberlin shattered the harmonious edifice so diligently constructed over the last century. Goods were heterogeneous and indivisible, mobility imperfect, numbers not necessarily large, some prices were sticky, supplier could manipulate demand through advertisement and, above all, knowledge was always deficient. As a result of these fresh insights the belief in the automatism

of the economic process was yielding to a recognition for the need to control this process in varying degrees. It was not however, the academia which forced this realization upon the economists, but the rude reality intruding upon their peace in the form of the Great Depression in 1929 (1337-8 AH). "The masses of the unemployed and the idle productive facilities, during the depression, made many economists realize that major economic problems had been excluded from orthodox economic theory and that their micro-instruments of "the logic of choice" were completely inadequate to tackle the problems society then faced,"¹⁰ to put it rather mildly.

F. Keynes' Theory

Keynes' General Theory (1355 / 1936) offered an entirely new kit of tools and broke away from the traditions of the Marginalist analysis by employing such categories as aggregate demand, aggregate supply, savings, investment and volume of employment and national income. He discarded the assumption of perfect knowledge and certainty by pointing to the ignorance that pervaded decision making and emphasized the veritable nature of the expectations of which investment was based. He denied the causal nexus between interest and savings, and emphasized the rigidity of wage rates. He regarded money to be much more than a mere numeraire by making liquidity preference a crucial factor in his analysis. He did not have much use for the classical fascination with equilibrium either. Thus the whole apparatus of neo-classical analysis was, if not declared useless, relegated to the position of being specific to certain uses and supplemented, if not entirely replaced, by a whole set of new ones. More important than these formal changes was, however, the reference to social reality which provided the justification for doing so and served as a grim reminder to the fact that, after all, economics had a purpose.

Whereas the classicists were convinced they understood human nature, Keynes hardly pretended he did. Whereas they confidently proceeded to deduce everything else from what they thought they knew, Keynes' analysis rested on facts as he observed them. And as all that needs be known cannot be, his conclusions are often in terms of 'mays' rather than the 'musts' his predecessor's methodology yielded. Unlike the Cartesian roots of the classical methodology, Keynes' method had affinity with Existentialism. As a matter of fact it is hard to ascribe a definite methodology to Keynes. He was pragmatic, making use of deduction sometimes but mostly being guided by empirical truths and a sense of what was desirable. He looked forward to proper manage-

¹⁰ Sachs (ed), *Main Trends in Economics*, (London, George Allen and Unwin), p. 18.
This point has been stressed by many historians of economic thought. See amongst them Sydney Weintraub, *Modern Economic Thought*, (Basil Blackwell, Oxford, 1977), p. 34.

ment of man's economic affairs, the efforts to understand and analyze were a means to this end. Many macroeconomic categories and some macroeconomic analysis can be traced back to the classical economists, but was no macroeconomic policy. Once economic policy came to the fore, the social institution primarily responsible for implementing any policy, i.e., the State, became one of the chief actors on the economic scene. Indeed one of the greatest contributions of Keynes was bringing home the realization that the Market could not always be relied upon and recourse to State action was a constant feature of economic life even in a free enterprise system.

G. The Contemporary Scene

Economics was never the same after Keynes, although neo-classicism did reassert itself by reinterpreting Keynes and introducing variables into his 'model', which his interpreters never imagined he would have deliberately left out. Time and space do not permit us, however, to trace these developments further. Nothing has happened since Keynes which could compare in significance with the advent of classicism, the rise of Marginalism, the Marxian critique and the Neo-classical synthesis. We will turn now for a brief look at the present state of the art. Three distinct stands can be noted:

- (1) Mainstream economics which assimilated Keynesian contributions into neo-classicism by adding macroeconomic theory, including macroeconomic theories of distribution, to economics, and by allowing macroeconomics to dominate policy studies, but holding on to the microeconomic theory of value and distribution centred around rational choice, demand and supply, competition of various types and the equilibria and optima resulting from the market process.
- (2) Revival of the historical and institutional or, to put them together, as an evolutionary methodology. It advocates a holistic approach and openness to ideas and methods from other disciplines such as sociology and political science. Instead of merely focusing on 'what is', evolutionists ask 'how' did the economy get there and 'where' it is leading us. Galbraith has drawn attention to a number of formative factors conventional economics fails to consider, 'power' being the most prominent among them. The postwar period witnessed a great spurt in literature on growth and development, analyzing the causes of under-development and exploring possible strategies of development. This brought historical

and sociological considerations to the fore and exposed the limitations and weaknesses of abstract economic laws. Myrdal's *Asian Drama* is one of the best examples of this trend. Development economics has strengthened the case for mechanisms other than the market to get things done. The state has to play a crucial role in this process.

- (3) The Marxist critique of capitalism also took a more positive shape in writings of authors like Baran and Sweezy. Armed with new concepts like that of 'potential surplus' they pointed out the costs that growth through free enterprise capitalism entailed, thus joining hands with Veblen who had earlier exposed the predatory nature of competition. The Marxists did not show much of a success, however, in constructing a theory of rational organization of productive forces in a socialist society, not to speak of a distinct theory of economic behavior relevant to a socialist society. An important by-product of their efforts was, however, the almost universal acceptance for the realistic view that market and plan were complementary and economic analysis defied a dogmatic approach.

The radical economists are also important as far as their critique of neoclassical economics is concerned, but thus far they failed to evolve a viable alternative. Mainstream economics' concentration on small marginal changes and shifts within a capitalist system prevented it from a meaningful analysis of production and distribution which often required consideration of large qualitative changes. It also failed to take into account the actual socioeconomic determinants of productivity and excluded important social and political variables from its analysis. It had no method to deal with the negative costs outside the market system such as pollution and depletion of resources. These and numerous other criticisms are impressive enough to shake one's faith in the received doctrines and methods, but the question is, where do we go from here?

Though our review has been critical, two centuries of economic theorizing did add something to man's insight into his economic life and his ability to manage it for good or bad. One can lose sight of the complex reality only to his peril, but it does help to be able to grasp certain uniformities and long term trends which can be discussed despite the complex variety and vicissitudes. The supply-demand analysis, the kingpin of classical-neo-classical analysis is one such example. Focusing on the margin to trace the consequences of changes in economic variables is a useful technique in itself, only if one learns to discard it when the changes are out of the ordinary. The concept of equilibrium also helps understanding provided one does not attach any ethical

significance to it and remember the 'other things' assumed to be given. Many other examples can be cited, especially when the contemporary, often moderate and more qualified, versions of economic doctrines are considered.

We have already noted that one of the key drawbacks of the market is that it 'does not provide within itself any defensible income distribution'.¹¹ "The integration of distribution as an explanatory variable in the theoretical framework of economics has to be accomplished on both (a) *positive analytical* and (b) *normative grounds*."¹² Since "the organizing principles of economic system guided by exchange values are incompatible with the requirements of the ecological system and the satisfaction of basic human needs,"¹³ a broader approach to economic problems is called for. This leads Kapp to observe that "The new task of economics would be to elucidate the manner in which collectively determined social goals and objectives could be attained in the most effective and socially least costly manner."¹⁴ "Collective determination of social goals" raises, however, an epistemological problem. The contention that the market translates individual preferences into social goals has been demonstrated to be untenable. That the democratic process can do so still begs the question whether individuals always *know* what to prefer. Furthermore choice involves both preferences and opportunities¹⁵; how to broaden and equalize the opportunities for every one brings the whole issue of social goals back.

Economics in its Western tradition never considered the possibility of referring to some source higher than human preferences for arriving at social goals. All schools of economics accepted self-interest and pursuit of material progress as the norm despite weak efforts to discuss altruistic behavior and quality of life that involved non-material dimensions. That self-interest and pursuit of material progress alone are not in harmony with the human situation, is a realization calling for exploring the possibilities of changing the current attitudes which are largely the creation of Western sensate culture in which economics has been a major contributor.

To sum up, economics matured as an independent discipline in the West in a cultural milieu which idolized material prosperity and accepted self-interest as the normal human motivation. It extolled individualism and disfavored state intervention in economic affairs. Though the need of some state action is now admitted, attention is still focused on the theory of rational choice and the market is regarded as the main mechanism for translating individual preferences

¹¹ Kenneth J. Arrow, *The Limits of Organisation*, (New York W. W. Norton and Co., 1974), p. 22.

¹² Kurt Dopfer (editor), *The Economics of the Future: Towards a New Paradigm*, (Westview Press, Boulder, Colorado, 1976), p. 25.

¹³ K. William Kapp, *The Open System Character of the Economy and its Implications* in Kurt Dopfer, op. cit., p. 95.

¹⁴ K. William Kapp, op. cit., p. 102.

¹⁵ K. E. Boulding, *Economics As a Science*, (McGraw Hill, 1970), p. 124.

into the *how* or *why* of *which* economics, but does not enquire into social solutions of production, distribution and consumption. Mathematical techniques are employed to study functional relation between macro and micro economic variables. There is a strong bias against any variables which cannot be handled mathematically. Non-economic factors are generally excluded from analysis. Behavioral laws and functional relations should, in the context of minimization of costs or maximization of returns, constitute the core of economic theory. This core is surrounded by studies relating to Monetary and Fiscal Policy, Distribution, Growth and Development, Labor and Organization, International economic relations, etc., which admit of ends and policy options. Using the concepts and tools perfected in theoretical analysis these studies also admit of control and planning situations and tend to incorporate sociological and historical material. Most of the differences in their approach to current problems between mainstream economics in its conservative (Friedmanian) and liberal (Samuelsonian) traditions on the one hand and the Radical and Marxist economics on the other, relate to these areas. They do not disagree on such basic assumptions as the primacy of self-interest or supremacy of material progress, or the capacity of man to *know* what is good for himself.

II. Nature and Content of Islamic Economics

To be meaningful and relevant, economics must explicitly recognize its purpose. It is man's concern with survival, hence the primacy of need fulfilment, which prompts him to understand nature and society. Man is a social being and society requires a just order. Justice had always been the major concern of social thinkers, especially those morally inspired. Then come the concerns for efficient use of resources and growth with a promise of convenience, comfort and dignity which nature can well afford. These ends are to be realized within the framework of freedom which is the very essence of being human. Once the moral purpose of economics is recognized formal techniques of analysis would cease to be ends in themselves determining content of economics to the exclusion of what a method cannot handle even though its consideration may be basic for the overall purpose. To some extent the current methodological crisis in economics is a product of this realization of the primacy of ends over means of analysis.

A. The Islamic Tradition in Economics

Economic thought in its Islamic tradition has always been inspired by moral purpose. This followed from clear Islamic injunctions laying down social goals

and individual norms of conduct relevant to man's economic life. The Qur'an itself outlined a definite framework for the organization of man's economic life which could and did provide a distinctive paradigm for Islamic economics.¹⁶ To note its salient features: The world of nature is there for man to make a living out of it, promising sufficiency for all human beings. Man has to ensure this through his efforts for which he has freedom of ownership and enterprise. Justice must, however, be ensured, if necessary through law. Cooperation and benevolence rather than self-centeredness and avarice should be the norm for men in economic affairs. Allah (SWT), being its real owner, property has to be handled as a trust and all economic activity conducted in the framework of trusteeship. Poverty is an empirical reality, hence the rich must surrender a part of what they possessed to the have-nots. Trade is lawful but *ribā* interest is prohibited. Waste is sinful and it is imperative to economize and be sufficient. Worldly wealth should be treated as a means to good normal life leading to eternal bliss rather than as an end in itself. The Prophet (SAAS) reinforced this approach with his elaborations. There is a clear emphasis on a cooperative attitude, the motto being: "utilize the resources given by Allah, including your own abilities, to live and help others live a well provisioned life conducive to moral excellence." It was this motto which inspired the rightly guided caliphs in their management of the economy, the jurists in their working out the details of the *Shari'ah* relating to economic affairs and the social thinkers when they surveyed economies, and made policy recommendations. Thus we find AbūYūsuf¹⁷ (123-182 AH / 731-798 AC) emphasized need fulfilment and justice and reminded the ruler of his responsibilities in this regard. He argued in favor of efficient management and elimination of waste. Individual freedom was not to be encroached upon unless inevitable and the social authority should arrange for growth and development. He derived his ends from the Qur'an and the *Sunnah* and did not hesitate to refer to the generally recognized good (*ma'rūf*) for complementing the same. His method was flexible, resorting to deductions when needed and inferring from facts of life frequently. He analyzed with a purpose, but was always faithful to facts. In making policy recommendations he frequently referred to the ultimate goals mentioned above: need fulfilment, justice, efficiency, growth and freedom. This is brought out very well by his discussions on the economic

¹⁶ For references on this point and what follows the reader may refer to the author's *Muslim Economic Thinking: A Survey of Contemporary Literature*, (chapters one and two and the relevant items in the bibliography appended to the same volume. The Islamic Foundation, Leicester, 1981).

¹⁷ For references on AbūYūsuf see the bibliography mentioned above and the author's forthcoming paper on *Recent Writings on the History of Economic Thought in Islam*, to be published by the International Centre for Research in Islamic Economics, Jeddah. The best reference is, however, AbūYūsuf's *Kitāb al Kharāj* now available in English, translated by Abid Ahmad Ali and published by the Islamic Book Centre, Lahore, in 1979.

responsibilities of the ruler and on the tax system.

What applies to AbūYūsuf applies to economic thinking in Islam in general. This is not to deny variety in emphasis and scope of the economic thinking of AbūYūsuf and other great scholars like Abū'ubayd, Ibn Khaldūn, Ibn Taymiyyah, al Ghazzali, al Ṭusi and Shah Waliullah of Delhi. This, however, is not the time and place to discuss these distinctive features.¹⁸ What concerns here are the common elements shared by every Islamic thinker noted above. All these writers analyzed the existing economic reality with reference to the social goals and norms of individual behavior they derived from *Shari'ah* and proceeded to make policy recommendations designed to transform the existing reality into what they considered to be Islamic ends and values. In doing so they were also influenced by the social and political conditions of their times and their sense of what was within the range of possibilities. They had a practical approach to the problems though some of them, like Ibn Khaldūn and Shah Waliullah, did strive at valid generalizations valid far beyond their time and place. The jurists among them also tried to deduce from particular traditions, rules and laws of general validity. But we do not propose to go into the details of the methods followed by various scholars. What we wish to note is that our scholars had an open mind as far as methodology was concerned. Their theory of knowledge told them that only Allah (SWT) had all the knowledge and that man's knowledge was always deficient, even with respect to what concerned him directly. Just as human knowledge was limited, so was reason deficient to decide what was good. Man was in need of *hidayah* (guidance) from Allah (SWT) which was duly provided through the Prophets (AS) and the Books revealed to them. Divine guidance was therefore the starting point of all social thinking and economics was no exceptions. We first enquire of what is desired by the *Shari'ah* and what rules are already prescribed for its realization. With reference to the actual economic problems facing man and society not directly covered by *Shari'ah*, we try to infer the appropriate rule by analogy wherever possible and by reasoning in the light of the public good (*maṣlahah*) where necessary. In order to make laws for society, or prescribe good behavior to the individual or recommend a policy to the ruler, one has to analyze the reality, unburdened by any notions that are not derived from the Qur'ān and the *Sunnah*.

B. Three Components of Islamic Economics

It is possible to identify three distinct components in Islamic economics.

¹⁸ This has been attempted in the paper on *Recent Writings on the History of Economic Thought in Islam* mentioned above.

First, it requires an enquiry into the ends and values cherished by Islam which are relevant to economics. It involves goals of social policy as well as rules of conduct and norms of behavior for the individuals. In terms of old Islamic categorization this component of Islamic economics belongs to the *Ulūm al Shari'ah* or *Naql* (tradition). But reason has a vital role to play at two levels. It is involved in analogical reasoning or *qiyās* which is a recognized method of translating the precepts of Qur'ān and *Sunnah* into rules and policies applicable to situations not directly covered by these precepts. Second, reason is called upon to interpret the *maṣlahah* (public good) and what is *ḥasan* (good), categories to which frequent reference is made in the Qur'ān, in situations where analogical reasoning does not help and *ijtihād* (independent exercise of judgement) is inevitable.

This is an area on which expertise in *Shari'ah* studies and economics must converge. The case for the former is obvious, the latter is required for indicating the relevance of any particular precept for economic affairs. It is the economist—one who specializes in the knowledge of the economic problems and processes—who can discern the relevance of particular *Shari'ah* rules or its general precepts for real life economic problems. Whether the two expertise are combined in the same person or persons having expertise in *Shari'ah* or economics join together is a matter of detail and organization. What is important from the view point of defining the nature and scope of Islamic economics and its methodology is that this component is an integral part of Islamic economics. Islamic economics begins with an understanding of Divinely ordained ends and values and cannot be conceived without them.

The second component relates to the analysis of human behavior, social relations, processes and institutions which relate to production, distribution and consumption of wealth which fulfil needs, provide comfort and contribute to progress. This is the task positive economics is meant to perform, but as we have seen above, its methodology has limited its scope. Islamic economics is open to a variety of approaches including the historical and the sociological. Islamic economists may make full use of the past contributions in understanding the existing economic reality. They are, however, aware of the fact that modern economics facility assumes Western modes of behavior to have universal validity.¹⁹ As their first object of study is the economic reality obtaining in their own countries they better not start with preconceived notions about human motivation. Even where a particular motivation not in harmony with the Islamic values does exist they do take it as given but go beyond the existing reality to the historical or institutional elements responsible for it. Take for example the degree of risk aversion among depositors in the present society which has become used to interest, as compared to an equity based Islamic

¹⁹ Joan Robinson, *Exercises in Economic Analysis*, (London, Macmillan, 1963), p. xvii.

system where interest could not exist. While it would be unrealistic to deny the comparatively higher degree of risk aversion in the present society, it would be naive to consider it natural, or universal. The same may apply to the extent to which self interest dominates the behavior of the consumer or the firm, or to liquidity preference and the speculative demand for money. The analysis of what it must take into consideration why it is so, how it came about and in what possible ways it might change under the influence of a different environment, a different value orientation, a different institutional arrangement etc.

This leads us to the third component of Islamic economics: an enquiry into how to transform what *is* into what should *be*. This enquiry may be conducted in two stages. We may first ask the question what would be the results if every economic agent (ignoring the state) behaves as it ought to (which is defined in the first mentioned component of Islamic economics). The state is brought in at the second stage for remedial action and activities supplementing or complementing the market under influence of Islamic values with a view to ensuring the goals defined in the first component discussed above. In other words, the goals set by *Shari'ah* have got to be realized; the strategy is to realize them through Islamically oriented actions in the market as far as possible and let the state do the rest. This again is a distinctive component of Islamic economics, being a necessary complement to its first component. It involves analysis based on a new set of hypotheses as well as policy studies.

Islamic economics is therefore both a science, analyzing its data, and an art, discussing ways of creating a new order. The two can be distinguished from one another conceptually, as we have tried to do in defining the content of Islamic economics above, but the economist cannot always keep them separated. There is in fact no need for doing so as long as one guards against the naivety of projecting into reality what in fact does not exist, his vision of the desirable order, for example. The early masters like Adam Smith, J. S. Mill and even Alfred Marshall always combined the two elements in their writings. Keynes' General Theory is as much essay on how to manage the economy as an analysis of how the economy actually functions.

III. Progress of Islamic Economics

The primary Islamic concern in man's economic life has always related to need fulfillment, justice, efficiency and growth, and freedom in about that order of priority, depending on the circumstances in which a particular thinker wrote on the subject. These goals are squarely rooted in the Qur'an and the

Sunnah and provide a framework which accommodates almost every past contribution to the subject. Modern economics has, on the other hand, focused primarily on efficiency and growth, the issues of justice and need fulfillment being forced upon it by economic crises or attacks from radical quarters, to which attacks, the orthodoxy has generally responded by extolling freedom as the overriding concern. These goals never got an integrated treatment by any school of economics. True to its outlook on life and society, and in continuation with its past traditions, contemporary Islamic economics has taken up the three dimensional task of defining the Islamic ends and values, analyzing the existing economic reality and exploring ways and means for transforming the existing into the desirable pattern of things. The above mentioned concern stands out clearly in the literature on Islamic economic system, but that is not what primarily concerns us here. We would rather focus on the contributions of a theoretical nature made by Islamic economists recently. As a comparatively recent survey is already available,²⁰ we will note only the main points without referring to particular authors.

Most of the theoretical work done so far answers the question: How would a particular economic agent behave under the influence of Islamic ends and values, and what would be the resulting order of things? Mostly the analyst proceeds further to discuss the remedial or complementary role of the Islamic state in order to arrive at the desired order of things.

A. Consumer Behaviour

Applied to the consumer the main conclusions have been as follows:

- (1) Abstinence from prohibited items of consumptions (e.g., pork, wine etc., hence no market demand and no resources allocated for their production (ignoring for the sake of simplicity, the non-Muslim consumer's demand).
- (2) Moderation in consumption resulting in avoidance of waste and fall in the demand for luxury goods. The state is envisaged as ensuring a production mix that prevents resources from being spent on luxury items which the conditions of a particular society may not allow.
- (3) Consumer behavior is oriented toward a welfare function which covers the well being in life after death implying a concern for the welfare of others.
- (4) The rationality assumption is retained as modified in accordance with (3) above.

²⁰ Muhammad Nejatullah Siddiqi, *Muslim Economic Thinking*, op. cit.

- (5) Since the market mechanism serves only those who have purchasing power, consumer needs which are not backed by purchasing power, especially when the needs are basic for survival, necessitate social action. This may take anyone or more of the following forms:
- (a) Transfer of purchasing power from the rich to the poor, directly or through the state.
 - (b) Subsidizing the production of necessities in order to increase their supply and/or bring down their prices.
 - (c) Price control, rationing and other direct means of need fulfilment.

These conclusions relate to the third component of Islamic economic according to our scheme. Contributions relating to the first component; ends and values, abound in the literature. Analysis of consumer behavior as it is, which corresponds to our second component, does not make any significant departure from conventional analysis. As a matter of fact very little attention has been paid to it till now despite the general feeling that conventional analysis leaves out altruistic behavior and influence of custom and tradition.

Regarding the transformation of the existing reality into the Islamically desirable order emphasis is placed on education and inculcation of Islamic values in individuals, voluntary action on part of concerned groups and institutions in the society, and state action by way of information, direction, planning and direct intervention. Further details are lacking due to the neglect of the second component: analysis of existing consumer behavior in Muslim societies.

B. Behavior of the Producer

- (1) Profit maximization subject to constraints imposed by the interests of the society (*Maṣlahah al 'Ummah*). This may involve other objectives too, such as increasing employment opportunities, keeping down the prices of necessities, increasing the supply of certain goods which have social priority etc.
- (2) Cooperation with other producers with a view to achieving social objectives.

Though cooperation is frequently emphasized in the context of Islamically oriented behavior, especially among producers, it is not clear what forms it is expected to take and to what extent the outcome will be different from that obtaining in the competitive model. Cooperation in order to maximize profits would lead to monopoly. This is, therefore, ruled out as monopoly in that sense it unanimously considered to be un-Islamic. It is cooperation in order

to achieve some of the other objectives mentioned above that is relevant. Insofar as these objectives are social, their pursuit requires much more information than is normally available to the individual producer. Cooperation for promoting social interest and realizing public good would therefore involve other social institutions especially the state. It may also require a different kind of interaction with the consumers and the laborers.

Case studies on the behavior of Muslim producers (past as well as present) would have helped, but none are available. How to transform existing behavior into the desirable one is also not discussed in detail. The available material is confined to the first component and the influence of Islamic values on behavior as noted above.

C. The Price Mechanism

It is agreed that the shape of the supply and demand curves as depicted by the conventional analysis is valid, subject to the usual qualifications. But no moral approval can be given to prices so determined unless the market is free from deception, coercion, hoarding, monopoly and similar evils and the distribution of income and wealth is fair. It is noted that the latter condition is not satisfied in any contemporary society. Assuming that both conditions are satisfied the resulting prices are acceptable but not sacrosanct. The social authority may still intervene if doing so is necessary for realizing social goals, but it is preferable to try other means and let price controls be the last resort. This would suit the objectives of freedom and efficiency, exception being made only when it becomes necessary to secure justice and ensure need fulfilment.

Islamic economists emphasize the influence of Islamic values on the functioning of the market and hope to see better results in terms of allocation of resources and need fulfilment. No attempts have been made to support this contention as shown by case studies, even dating from early Islamic history.

D. Distribution

Wages are allowed to be determined by the market, subject to a minimum wage constraint. The same applies to profit and the ratios of profit-sharing (between those who supply money capital and those who employ it in productive enterprise). The same may apply to rent. Unfortunately, distribution is one of the least researched areas in Islamic economics, and this deficiency is very conspicuous concerning the nature and rationale of rent in an Islamic economy. A theory of distribution is especially called for in view of the high

priority attaching to justice and need fulfilment. Islamic economists affirm that the reduction of inequality in the distribution of income and wealth is a policy objective. A macroeconomic theory of distribution applicable to an Islamic society has the potentiality of identifying the possible policy options in this regard. But the subject has been generally discussed in the context of *Zakah* and the Islamic laws of inheritance. A more comprehensive treatment at the microeconomic and macroeconomic level comprising all the three components of Islamic economics (ends and values, existing reality and market solutions under the influence of Islamic norms of behavior and policy directed at a transition toward the desirable pattern) is very much needed. It is on the basis of such study that a role for the Islamic state, providing a just distribution of income and wealth and in maintaining balance over time, can be envisaged. In the absence of this basic work, opinions vary from 'radical' suggestions on socialization to legalistic approaches aimed at perpetuating the status quo.

E. Theory of Income Determination

The basic Keynesian tools are employed by some writers to discuss income determination in an Islamic economy in which the rate of profit and the ratios of profit-sharing play a crucial role since interest disappears from the scene. Another significant point made recently is the integration of savings and investment decisions in an interest-free economy and the resulting close linkage between the financial and real sectors of the economy. Productive enterprise in an Islamic economy will be financed by equity debt financing playing only a marginal role. The dominant factor determining the behavior of both investors and savers will, therefore, be expectations regarding productivity. It is argued that *Zakah* will discourage idle savings and encourage investment. Thus productive enterprise will be encouraged due to the replacement of contractual interest obligations by an agreement to share the actual returns. The overall effect, it is argued, will be to increase the volume of investment leading to a higher level of income and employment, other things being equal.

F. Monetary Economics

Replacement of interest by profit-sharing has been shown to have far reaching consequences. Some of the important points are noted below:

- (1) Money creation will become investment oriented and will cease to be based on lending as it is now. This applies to high power money created by the central bank as well as to the creation of credit by the commercial banks. This direct linkage makes

it possible to control the supply of money *pari pasu* with the growth of the economy far more effectively than it is possible in the present system.

- (2) Demand for money would be a function of the level of income and expected changes in the productivity of investment as reflected in the rate of profit. It is argued that demand for money will be more stable in an Islamic economy than it is in the regime of interest.

The same applies to such areas as labor, industrial relations and population. Discussion is generally confined to principles while the requirements of the second and third components of Islamic economics are not fulfilled. The same can be said about international economic relations. Even the goals of policy in an international context are not properly discussed. Independent analysis of the existing reality and strategies for Islamic transformation of international economic relations are attempted only with reference to Muslim countries. A more universal framework has yet to be adopted.

It may be noted that the Islamic vision has not prompted equal attention to all dimensions of economic management or all spheres of economic activity. Greater attention has been paid to Islamically oriented behavior of economic agents and functioning of the market mechanism under its influence. The monetary sector has such attention because the abolition of interest is a major Islamic contribution to economic affairs. The second component, analysis of the existing reality, is essentially very weak. One reason may be non-availability of empirical data relevant for such studies. Most theoretical studies belong to the third component but they suffer from the dearth of material relating to the first component, i.e., derivation of Islamic ends and values specifically related to the various spheres of economic activity. This applies even to monetary economics which has high priority in contemporary Islamic economics. A major reason for this deficiency has been the inability of professional Muslim economists to acquire direct access to Qur'an, *Sunnah*, *Fiqh* and Islamic history. Contributions from *Shari'ah* scholars generally lack relevance because they are not fully aware of the specific issues relating to various aspects of the modern economy. Proper development of Islamic economics as a discipline or, put differently, a thorough Islamization of economics requires, besides pioneering individual contributions, organized institutional efforts which only the universities and institutes of higher learning can afford. The progress made so far, which has been mostly due to individual efforts, is both relevant and encouraging in view of the present state of economics and the unanswered needs of the society.