



Islamic Economics: A Survey of the Literature

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Glossary of Arabic words

References to the Quran are given in form [Qxx:yy], where xx is the number of the Surah and yy is the number of the Ayah. These can easily be looked up from many sources, including the website <http://www.islamicity.com/QuranSearch/>. Unless otherwise indicated, Hadeeth that are cited can be looked up from <http://www.muhammad.org>.

The Islamic Calendar is a lunar calendar which starts from the date of emigration (*Hijra*) of the Prophet Mohammad (May Allah shower his peace and blessings upon him)¹ from Mecca to Medina, which took place in 622 AD. Since the lunar year is about 11 days shorter than solar, for a very rough conversion, multiply the Islamic year number by 0.97, and then add 622 to get the Gregorian year number

Farz: Compulsory, according to Islamic Law. Actions are classified as being *farz*, or obligatory, and *nafil*, or optional acts of worship. Then there is the *haram*, or prohibited category. Among the *nafil* acts, there can be varying grades of compulsion or necessity.

Farz-e-Kifayah: Collective responsibility of a community. If not fulfilled, it becomes *farz* (compulsory) for everyone individually. If it has been fulfilled by some members, then others are absolved of the responsibility.

Fiqh: Rules of derivation (and the methodology for development of such rules) used to apply Islamic law to situations not directly covered by source materials for Islamic law.

Gharar: uncertainty or ambiguity about price or product, which renders a sale invalid according to Islamic law.

Hadeeth: A report of a saying or action of the Prophet Mohammad (May the peace and blessings of Allah be upon him). Such a report must be accompanied by a list of narrators.

Halal: Permissible, according to Islamic law.

Haram: Forbidden, according to Islamic law.

Ijtihad: The process of deriving rulings of Islamic law in new situations not covered by traditional rulings.

Infaq: Giving money or property for the betterment of society, in order to earn the pleasure of Allah.

¹ It is part of Islamic etiquette to invoke peace and blessings upon the prophet Mohammad whenever his name is mentioned.

Jihad: Struggle. Refers to holy war, waged solely for purposes sanctioned by Islam, and without any mingling of worldly purposes, such as material gain, conquest, or glory. It also refers to spiritual and moral struggle for self-purification, and this has been referred to as the greater *Jihad* in Islamic tradition.

Kharaj: A tax on landholding which may be based on land value or on production.

Khilafat-e-Rashida: The rightly guided Caliphate. Refers to a period of about 30 years following the death of the Prophet Muhammad (May peace and blessings of Allah be upon him), where the rule of the Islamic world was in the hands of people trained by the Prophet. These people had both temporal and spiritual authority, and hence established 'the Kingdom of God' upon earth. After this period temporal and spiritual authority were separated (as predicted in Hadeeth), and Muslim rulers were no longer regarded as spiritual authorities by the public.

Riba: Literally, increase, but in Islamic law, any pre-agreed excess against grant of time in sales on deferred payment, or on loans; or as a premium (e.g. for quality) in the exchange of six commodities (gold, silver, wheat, barley, dates, and salt) in which unequal exchange is prohibited.

Shari'a: 'Islamic law' is the usual translation, but the meaning is broader. *Shari'a* is the set of rules which govern behaviour of Muslims in all realms of life, from internal states of heart and personal affairs to social and political and global affairs. These rules may be directly specified in Islamic source materials, or else deduced from such sources.

Shoora: The process of consultation for decision making by Muslim groups, recommended in the Quran. This process is subject to Islamic law, as described in many texts.

Sufi/Sufism: Sufism is the inner, mystical, and spiritual dimension of Islam, and a Sufi is the practitioner of this tradition, which leads to the training of the heart in directions required by Islam.

Ulama (singular '*'Alim*) : Scholars of Islam.

Ummah: The community or brotherhood of all Muslims. This can also be used to refer to the community of all human beings,

Ushr: Payments for the poor of 10% from agricultural produce.

Zakah, Zakat: Payments to the poor of 2.5% from wealth.

*In the name of our Creator *Allah*, the Merciful, the Beneficent*

1 Preface

1.1 Self-knowledge and knowledge of others

Q2:269 and whoever is granted wisdom has indeed been granted wealth abundant.

The treasure of knowledge gathered by our ancestors, which is the collective heritage of mankind, is vast. It represents the cumulative effort of generations over centuries. No human can hope to acquire more than a small fragment of this treasure. No human can subject more than a very small percentage of this heritage to critical examination. This means that a vast proportion of what I know and what you know is received knowledge which we have accepted without questioning. The knowledge that we have is strongly conditioned by the streams of history in which we live, but we are largely unaware of this. This creates a dilemma: we have no choice but to trust the cumulative body of received knowledge, yet there is always the possibility of systematic and widespread errors in this body of knowledge. If nearly everybody around us believes that the earth is flat, or that white races are superior to others, it is very hard for us to avoid such errors. There are two strategies which are effective in liberating us from the strands of the history that bind us. One is the study of the history of thought: studying how an idea emerged and how it was fashioned by the forces of history and vice-versa leads to substantial clarity and insight. A second strategy is to study the worldviews of those who have lived in a different stream of history and therefore come to a different way of understanding the world. Just as a mirror allows us to see our own face, so an alternative coherent worldview illuminates and clarifies our own worldview. ‘Seeing ourselves as others see us’ permits insights which are not possible from purely internal dialogues and discussions.

Divergent historical events have led to great differences between ways of viewing the world in European thought and in the Islamic world. These differences lead to misunderstandings and hostility, which are currently the source of conflicts and misery for large numbers of human beings in the Islamic world and outside of it. One major goal of this survey is to present Islamic views on how to arrange economic affairs in a society to a Western audience. I will focus on the contrasts between Islamic and Western views and show that there are coherent alternatives to prevalent and dominant Western views on the subject. This is subordinate to the larger goal of creating better understanding and sympathy across the cultural divide, in the hope that this will improve the conditions of human beings living on this planet. I also hope that understanding Islamic views, which closely match pre-modern Western views, will provide deeper insights into some essential but largely forgotten aspects of the Western heritage, as well as a better understanding of the roots of the numerous attempts to construct alternatives to modernity currently under way in the West.

Some methods and style of discourse utilized below are adapted to these goals, which are different from those of a typical academic paper. Excessive attention to detail would distract from the goal of providing a panoramic description of a coherent and integrated

alternative worldview. From among a complex and diverse set of Islamic views, I have often picked one or two for the sake of maintaining consistency across a broad spectrum of issues to be discussed. I have similarly chosen certain 'Enlightenment' perspectives to represent Western views, as these views offer the maximum contrast with the Islamic views. This approach is subject to the well-known weaknesses of the technique of 'binary opposition', but it serves my purpose here of sketching a coherent Islamic view on economic affairs with a minimum of brush strokes. I apologise in advance to both Eastern and Western readers with heterodox views who feel misrepresented by the sketchy characterizations offered of both poles of a binary opposition. Points of view offered as 'Islamic' below are supported by Islamic source texts and held by substantial numbers of Muslims, but are not necessarily majority or dominant views. A similar warning should be kept in mind for views labelled 'Western', by which I usually mean views emerging out of the Enlightenment project of rejecting religion and tradition, and relying on observations and logic as the sole source of trustworthy knowledge.

A peculiar aspect of knowledge is that one who does not have it does not know what he or she does not have. A non-mathematician will not be thrilled by the elegance of the Law of the Iterated Logarithms, will not be able to differentiate between trivial and deep results, appreciate subtleties, or evaluate the relative skill of experts and separate them from charlatans. Even more, that person will not be able to assess the difference that possession of such knowledge will make to his or her own life. Views like those of Macaulay's that "a single shelf of a good European library was worth the whole native literature of India and Arabia", cannot easily be refuted. The effort required to acquire alien types of knowledge will not be made by those who do not appreciate the value of this type of knowledge. Without investment of substantial time and effort, appreciation of a complex and sophisticated alien structure of knowledge cannot be acquired. Once acquired, it cannot be easily conveyed to others, especially to those disdainful about the value of such knowledge. The Arabic word for 'student' translates to 'seeker of knowledge' and an attitude of humility, as well as the desire or passion to acquire knowledge and to value it above all things, are essential characteristics for a student in the Islamic tradition.

1.2 Contrasting historical experiences with religion

In the sixteenth century, religion was central to human thought both in Europe and in the Islamic world. Subsequent events in Europe led to radical changes in ways of thinking in the West, but did not impact on the Islamic world. Large libraries of books are devoted to details of these events and how they affected the development of European thought. There is no way to summarize this material in a few paragraphs without introducing substantial distortions. It is nonetheless necessary to sketch a bare bones outline of the crucial historical events in Europe that are directly relevant to differences in European and Islamic views about how economic affairs should be organized in societies.

Violent religious conflicts and disenchantment with religion among intellectuals in Europe led to a search for alternatives to religion as a basis for social organization. Secular thought found replacements for traditional, religion-based answers to the questions of appropriate standards for individual and social behaviour, suitable forms and purposes of political and economic organization, as well as a myriad of others. Economic theory and other social sciences emerged as means for providing clarification of and support for answers to the questions that religion could no longer

provide. Two crucial ideas which lie at the heart of secular thought and are not consonant with Islamic views are the following:

- The assumption of shared values made possible by religion makes it possible to view society as an organic whole, united in a common purpose (*polis*). Common goals, values and purposes cannot be assumed in a secular society. Political and social organization must be re-conceived as a means of regulating conflicts and allowing people with disparate and conflicting goals to live together in peace (*societas*). Manicas (1989) discusses this transition from *polis* to *societas* in political thought as one of the key transitions associated with modernity.
- Since common goals cannot be assumed, ‘freedom/liberty’ and ‘wealth’, which are regarded as universal means to achieve all goals, are promoted to being the purpose of secular political and economic organization. Freedom is valuable only insofar as it is freedom to pursue specific goals of value, and not for its own sake. Setting up ‘individual freedom’ as a moral value and reconciling it with social obligations occupied many enlightenment philosophers, notably J. S. Mill (1859) in *On Liberty*. The ‘invisible hand’ of Adam Smith also defends freedom, purporting to show that individuals pursuing their self-interest will automatically lead to socially optimal outcomes. Austrian economics takes this further, saying that freedom to pursue self-interest is, by definition, the socially optimal outcome. Similarly, wealth is useful only as a means to some ends. Nonetheless, these means become ends in a secular system of thought. For example, Weber (1930, Chapter 2) writes that the “spirit of capitalism” is the pursuit of wealth as an end in itself, to the point of being “absolutely irrational”.

Muslim historical experience with religion has been entirely different from that of Europe. After a brief early period known as the Khilafat-e-Rashida (The period of the rightly guided Caliphs), temporal and spiritual leadership were separated in the Muslim world. Religious authorities were either intellectuals and scholars (*ulama*), spiritual leaders (Sufis) or both; they did not exercise political authority. Thus, political struggles in the Islamic world were not ascribed to religion. From the beginning, *jihad* or warfare was a religious duty and hence subject to very strict rules. The Islamic rules of *jihad*, containing equivalents of the provisions of the Geneva convention and prohibitions on hurting non-combatants and unnecessary destruction of property, served to ameliorate rather than exacerbate the horrors of war (see Feldman, 2003). In short, Muslim historical experience gives no reason to reject religion as a basis for organizing social, political, and economic behaviour.

1.3 The transition to secular thought and its consequences

The transition from religious to secular thought in Europe deeply influenced the development of social science. Secular thought emphasized the diversity of human goals and the primacy of freedom to choose. Wealth was seen as an essential component of freedom, as it allows individuals to do whatever they desire. Thus the pursuit of wealth became a social goal and a means of obtaining maximum freedom in a secular society. The contrast with Christian values, which denounce acquisitiveness and greed, has been spelled out by Tawney (1926). Insensibly, failure to prescribe what is to be done with wealth led to the pursuit of wealth itself becoming a goal, instead of a means to a goal.

Thus the answer to the fundamental economic question of what is to be done with surplus wealth became 'use it to generate more wealth'. Even though this answer is patently absurd, it is nonetheless deeply believed by many. *Economics as Religion* by Nelson (2001) provides many illustrations of how deeply held this type of belief has become and also how economic theory is described in theological terms by many leading economists. While it seems *a priori* obvious that wealth should be used to improve welfare, satisfaction, and happiness of individuals and society, some economists (notably Friedman, 2005) condemn diversions from the goal of pursuing wealth to pursue social goals in no uncertain terms.

Even though these ideas are easily seen to be products of particular European historical experiences with religious conflict, they are commonly thought to have universal applicability². The need to justify and rationalize European conquests led to the idea of the White Man's burden: that European culture, thought and socio-political systems are ideal forms and must be spread to the rest of the world³. Several authors described stages of growth which would be followed by 'primitive' societies to reach European levels of development. For example, Hegel (1837) saw history as a teleological process driven towards the goal of achieving European ideal forms of society. In the *End of History*, Fukuyama (1992) suggests that, with the dissolution of Soviet Union, we have arrived at this goal. All of these lines of thought converge on the idea that European thought is applicable to all societies, instead of being a product of special events of European history.

The emergence of the social sciences in the West is closely tied to the 'Enlightenment project', and attempts to find rational grounds on which to base social, political and economic structures. Theories in the social sciences often abstract from Western historical experiences, and often take Western institutional structures for granted as background. Mitchell (2002, p. 7) writes that "The possibility of social science is based upon taking certain historical experiences of the West as the template for a universal knowledge." The impact of history on the development of social sciences in the West has been ably traced by Manicas (1989) and also Gordon (1991). Wallerstein (1996) argues for the necessity of changing disciplinary boundaries and content in social science. Thus, there is strong evidence of the imprint of Western history on modern social science.

The conclusion that social science is 'Western' and not generally applicable is nonetheless strongly resisted by many. Enlightenment conceptions of knowledge as objective, external to the observer, and based on truth, suggest that the history, origins and context of knowledge are not important; Kuhn (1970) and Hacking (1983) provide an exposition of these theories of knowledge, as well as a critique. In addition, Western universalism suggests that all cultures are essentially the same as primitive Western cultures, and will mature into European patterns, thus making Western social science universally applicable; see for example Fukuyama (1992) or Wallerstein (2006). Post-modern Western thought has rejected both of these ideas. The attempt to fit all societies into the European pattern leads to clearly recognizable biases known as 'Eurocentrism'. Many aspects of the European experience are unique to Europe and were not (and cannot be) experienced by other societies. Insights of social science based on these particular European experiences are

² "In the end, then, despite the inevitable parochialism of our attachments to national societies and cultures, the change most required is the gradual acceptance of the realities of a common experience, ... all of us are now children of the revolutionary insight of seventeenth century Europe" (Rostow, 1978, p 657).

³ See, for example, Edward Said (1978) *Orientalism*.

peculiar to the West and cannot be generalised to other societies. Many authors have documented problems and errors resulting from Eurocentrism; see for example, Hodgson and Burke (1993), Marglin (2007), or Mitchell (2002). Specifically in the context of economic development, Arshad Zaman (1989) discusses historical differences between the East and the West which make Rostow's idea that all development will follow the European pattern implausible.

1.4 The emergence of economics in Europe

European history has had a tremendous impact on modern economic theory, in shaping the questions asked, as well as the questions not asked; in delimitations of boundaries; and in methodology. This influence is not generally recognized because of the assumption of the universality of Western experience, as well as the pretensions of economics to the status of 'science,' and an assumption that scientific truth is objective. Since the Islamic world has not been subject to these historical forces, formulations and discussions of economics in the Muslim world often reject settled answers and disagree with universally agreed upon assumptions of modern economic discourse. Our goal in this section is to bring out several key features of modern economic theory which are products of accidents of European history rather than natural ways of treating the subject matter. This discussion of the historical roots of Western economic theory is necessary because large portions of modern Islamic economics are responses to Western economic theory, albeit informed by different historical experiences.

1.4.1 The deification of science

European loss of faith in the certainties of religion (termed the 'Death of God' by Nietzsche) led to the search for alternative certainties on which knowledge could be reliably founded. Scientific knowledge was to take the place of sacred knowledge, and an intensive effort on many fronts was made to establish the superiority, objectivity, and certainty of scientific knowledge, and to distinguish it from other forms of knowledge; see *Science Defied and Science Deified* by Olson (1990). Mirowski (1989) has described how the tremendous prestige of Newtonian physics resulted in a self-conscious effort by economists to model their discipline along similar lines. Emulation of physics has led to the following elements of modern economic methodology which are quite alien to natural pre-conceptions.

Using just one law of motion for particles, Newton was able to present a unified treatment of a large number of apparently unrelated phenomena. Economists have similarly adopted maximization of utility as the sole acceptable principle of explanation for human behaviour. Surprising as it may seem to outsiders, explanations of human behaviour which take into account motivations other than selfishness or greed are not considered acceptable by modern mainstream economists. Physics-envy is only one part of the explanation of why this became the dominant methodology in economic theory. A number of other quirks of European/American history, described by Manicas (1989) among others, have led to this outcome. The story is further complicated by the recent emergence of a number of competitors, like institutional economics and behavioural/experimental economics, which challenge this dominant methodology. Our goals in sketching this history are to point out that the model of 'rational self-interest' is not 'natural,' does not correspond to actual human behaviour, and does not offer any special advantages over other

methods for constructing economic models. That this has become the bedrock of mainstream methodology in economics is due to specifics of the evolution of thought in Europe and the USA. The idea of regarding humans as solely motivated by selfishness is repugnant to Islamic traditions for many reasons, and this creates substantial divergence between Islamic and Western views regarding economic affairs.

Another development directly related to the tremendous prestige of physics and subsequent scientific developments in Europe is the emphasis placed on use of formal and mathematical methods in economics. McCloskey (1984) has discussed how Samuelson has used mathematics to impress and appear authoritative, and not because it adds any depth to the economic argument. Echoing complaints by many leading economists about the overuse of mathematics, Blaug (1998) writes that "Economists have gradually converted the subject into a sort of social mathematics in which analytical rigor as understood in math departments is everything and empirical relevance (as understood in physics departments) is nothing." Economics conceived as a set of natural laws, amenable to analysis by mathematical models, has also displaced a historical and qualitative approach to the subject; see Manicas (1989) for details. In contrast, the qualitative and historical tradition initiated by Ibn-e-Khaldun, termed by many the father of the social sciences, continues to dominate Islamic analysis⁴.

1.4.2 The de-moralization of economics

One set of natural questions about economic affairs relates to ethics, morality, and concepts of fairness and justice. If I hoard goods in anticipation of scarcity, and charge high prices, is this clever or is it immoral? Should one make profits from the misery of others? Is it fair to charge interest for the lending of money? Is gluttony sinful, especially when the money spent to combat the problem of being overweight is more than enough to eliminate hunger and malnutrition in the world? Should we increase taxes to provide more aid for reducing poverty? Do we have a responsibility to feed the poor of other countries at the expense of the wealthy in ours? Is it fair for the wealthy capitalist to exploit labourers by paying them a very low wage? These and similar questions were central to earlier formulations of economics in Europe. They are no longer part of the subject matter of economics, as currently conceived in modern texts. The questions cannot even be formulated or posed within the modern language used by economists. Many economists would consider them meaningless questions, while others regard them as outside the discipline of economics.

It was the convergence of several different sets of historical forces in Europe that led to this outcome. Himmelfarb (1996), in the *De-moralization of Society*, discusses the general weakening of the forces of morality in England. The transition to secular thought affected all the social sciences. Tawney (1926) has discussed how central economic problems were formulated and discussed in religious terms in the sixteenth century, but how references to religion in relation to economic affairs became rare by the eighteenth. The Reformation, the Enlightenment, and the drive to investigate social affairs using only logic and empirics, without reference to religion, were

⁴ While the mathematical approach nearly extinguished qualitative alternatives in economics (although they have re-emerged from hiding in the recent past), the same battle has had somewhat different outcomes in political science. See, for example, Monroe (2005), who appeals for a 'live and let live' approach which would permit qualitative and historical analyses alongside the dominant formal and mathematical ones.

important parts of this process. Many of the questions posed above are, however, centrally addressed in Islamic tradition. Some are clearly settled by source texts and others have been the subject of scholarly debate for a long time. Since religion has not been marginalized in Islamic societies, any Islamic formulation of economics cannot bypass these questions, nor can it treat them as being outside the domain of inquiry.

Another damaging consequence of the attempt by economists to emulate the physical sciences in the West has been a general failure to appreciate the possibilities and potential for change and transformation in human beings. Human beings are free to choose in ways not determined by their past. Studying the laws of motion for societies requires that this possibility be denied. In many of the social sciences, the importance of human agency and the potential for changes in cultural and group behaviour are recognized. However, these contemporary trends have not had any impact in economics. The idea that there are 'natural laws' governing economics, which is at the heart of modern Western economic theory, has had grave consequences. Just as we do not ask if it is fair or just that stones fall at 9.8 m/s^2 , so the 'natural laws' of economics shield us from taking responsibility for the hunger, misery and economic destitution around us. Recognition that any economic laws that exist do so as a result of our individual and collective decisions about how to structure our societies places a tremendous responsibility squarely upon our shoulders. We choose the economic structure of our societies by the form of legislation, the development of institutions, and by teaching our children to be kind and generous (or greedy and acquisitive). Shouldering responsibility for enjoining the good and prohibiting the evil, and for working to transform human beings from a materialist to a spiritual perspective, is fundamental to the message of Islam. This creates a great gap between Islamic and Western views on economics.

1.4.3 Empiricism and logical positivism

Logical positivism and related philosophies have been tremendously influential in shaping Western social science in the twentieth century. In general, philosophy of science was an attempt to give rigorous analytical and philosophical backing to the European intuition that scientific knowledge is different from, and superior to, other types of knowledge. In particular, scientific knowledge rests on objectively verifiable facts, and trustworthy logical derivations from these facts alone. Other types of human knowledge utilize intuition and unverifiable assumptions, posit the existence of unobservable entities, and may utilize unreliable or false logic. One of the explicit goals of logical positivists was to discredit religion as a source of knowledge. Attempts to accomplish this goal of differentiating between scientific and other types of knowledge eventually failed on many different fronts. This failure⁵, the 'death of logical positivism', has impacted on different fields within the social sciences in different ways. While many disciplines have made suitable adjustments to their methodologies and moved away from positivist precepts, mainstream economics continues to espouse positivist principles.

Reuben (1996) writes that in the 1870s, dominant Western views were that knowledge was all of one piece, embracing spiritual, moral and cognitive dimensions. All knowledge was held to illuminate the divine; thus in teaching physics, astronomy,

⁵ Van Fraassen (1980, p. 2) who is himself a staunch empiricist, writes: "Logical positivism, ... even if one is quite charitable ... had a rather spectacular crash."

etc., lecturers were expected to “attend only … to the beautiful truths which are to be read in the works of God.” In particular, morality was founded in empirical laws about human behaviour, and hence could be studied and justified by observations about human nature. By 1930s this unity was shattered, with positivism driving a wedge between factual cognitive knowledge and moral/spiritual knowledge. Science was considered to be value-free and distinct from morality. Economists have embraced the idea that their discipline is a science, and hence objective, fact-based and value free. Some of the distortions caused by displaying ethical and political commitments as universal scientific truths are discussed below.

Economic systems must be designed, justified and evaluated with reference to some goal for economic activity. However, in a secular society we must make room for a variety of possible values, and take care not to force our values on others. Weber’s (1918) assertion that social science should be value-free also became widely accepted. These contingencies of European history led economists to present their subject as a collection of facts and regularities – economic laws – which could be used by any policy maker for furthering state goals. Many authors have pointed out the strong set of values embedded in supposedly value-neutral economic discourse – see, for example Nelson (2001). Freedom, represented by free markets, free trade and wealth, are promoted as desirable values. People who resist disruptions that would be caused by the free operation of markets (such as ‘transitional’ unemployment and lack of job stability) are labelled irrational and their preference for tradition and stability over efficiency is considered an undesirable value. This illustrates Foucault’s thesis that “modern human sciences (biological, psychological, social) purport to offer universal scientific truths about human nature that are, in fact, often mere expressions of ethical and political commitments of a particular society”⁶. Values hidden in modern economics are not in conformity with the values promoted by Islam. The distinction between Western and Islamic views in this area is not, as often suggested, a distinction between positive and normative views, but between a hidden set of values that is in opposition to an explicit and openly stated normative framework.

1.4.4 Fragmentation of knowledge and disciplinary boundaries

It is commonly believed that the explosion in the quantity of knowledge has led to the fragmentation of knowledge. In fact, knowledge is unified by purpose. Having a sense of the broad outlines of human endeavour, and how it serves the human race, one can have an idea of how one’s efforts fit into this big picture. Current conceptions of science militate against this unity. Economists claim their discipline is ‘positive’. As scientists, they can only assess and explain the factual consequences that have resulted from different types of economic policies. Judging which policy is better or worse is a normative act, which in their view should be left to policy makers. This type of insulation and fragmentation (which has nothing to do with the explosion of information) has disastrous consequences. If policies enrich a few and impoverish many, or damage the environment and profit the multinationals, or lead to debt and starvation in poor African countries, the economist has nothing to say about it in his status as a scientific economist. The physicist who works round the clock to produce an atom bomb claims that he is not responsible for how it is used. A biologist has

⁶ Quoted from entry on Michel Foucault in Stanford Encyclopaedia of Philosophy (accessed 23 February 2008): <http://plato.stanford.edu/entries/foucault/>

discovered high yield varieties of rice which could feed the whole world. However, distribution, publicity, pushing for policies for adoption etc. are not within that person's specialty. Instead, if a multinational hires the biologist for developing a variety that is not fertile (so that it will be able sell new seeds every season), that person will do the work for a salary, and not ask whether this development will be harmful to the interests of humanity as a whole. Islam does not allow us to dissociate ourselves from the consequences of our deeds: "Those who point to the good (deed) are like the doers⁷." Similarly, those who are instrumental in evil are also responsible for the evil.

With increasing secularism, and the basing of knowledge on experience and reason, norms and values came to be regarded as unscientific. The glue of the common purpose of serving humankind, however, binds the strands of knowledge together. The idea that life arose by an accident and will perish in another accident denies all purpose to human existence and dissolves this glue, leading to the fragmentation of knowledge. Consider the field demarcation between psychology and economics. Economists refuse to consider the issue of how wealth and materials affect the sense of satisfaction, wellbeing, contentment or happiness that people experience, on the ground that these questions belong to the realm of psychology (see Gul and Pesendorfer, 2007). They consider it as the role of their profession to consider only how people can become wealthy. Recent inter-disciplinary investigations have revealed that attitudes towards wealth, the methods by which it is acquired, as well as interpersonal dispositions, can play an extremely important role in determining the satisfaction obtained by the pursuit of wealth. Lane (2001) and Layard (2005) have documented how vast increases in wealth in Western societies have failed to increase contentment, satisfaction and a sense of wellbeing. This has extremely serious consequences for economics – if determined efforts to increase GNP and wealth have detrimental consequences for human welfare, then what is the point of it all? At the very least, economists must pay attention to these issues, to ensure that the pursuit of wealth has a point in terms of increasing human satisfaction. Islamic views do not permit such separation and artificial boundaries between fields.

1.5 Outline of the paper

Knowledge is traditionally conceived of as being based on experience, observations and reason, and assessed in terms of being true or false. This is common to both Islamic and Western traditions. When religious tradition became contested as a source of knowledge, a deeper study of the sources and validity of different types of knowledge was made in the West. This led to an appreciation of the impact of history on knowledge. For example, Marx thought that theory was shaped by class interests, while Foucault argued that 'knowledge' functions to legitimize power structures. The idea that knowledge interacts with historical experience is central to this paper. Historical events are analysed in the light of dominant theories (existing knowledge), and suitable responses to the events are made. An analysis of the outcomes of these events and responses, again made in the light of existing knowledge, becomes part of the updated and new knowledge base. Thus experience shapes knowledge and is also shaped by knowledge.

⁷ From Sahih Tirmizi, Book 4, Chapter 14, Kitab-ul-'Ilm.

Exactly as Western economic theory has been shaped by the forces of history, so modern Islamic economics has emerged in response to recent challenges faced by Muslims. In Section 2, the origins of Islamic economics are outlined. First its origins in the history of early Islam, European colonialism and responses to the evolution of conventional economic thinking are discussed. Second, the reasons for its recent evolution are explored in more detail, in terms of problems facing Muslim societies and attempts to find solutions in conformity with Islamic traditions. Section 3 sets out the goals of an Islamic economic system. It considers some basic methodological issues, the Islamic view of human beings and the use of material wealth for spiritual pursuits. The following section explores the framework provided for Islamic economics by *Shari'a* or Islamic law with respect to property rights, the conduct of business and labour. As a preliminary to considering the role of government in establishing and operating an Islamic economy, political aspects of an Islamic state are considered briefly. The remainder of Section 5 considers various key elements of economic management: public finance, distribution, social justice, security and welfare. In Section 6 the nature and role of various institutions is discussed: financial institutions, insurance (*takaful*), endowment or trust (*waqf*), and audit or accountability (*hisbah*). Finally, brief sections consider issues related to environmental protection and use of natural resources, and the principles governing the economic behaviour of individuals.

2 The origins of Islamic economics

Q9:111 Allah hath bought from the believers their lives and their wealth in return for Paradise.

A large number of the teachings of Islam deal with economic affairs. One of the five questions Muslims will face on Judgement Day will be: "How did you earn your wealth and how did you spend it?" Our earnings must come from *halal* means (permissible according to Islamic Law), and must be spent on *halal* categories of expenditure. The necessities of governing an expanding empire led early Muslim writers to discuss *halal* methods for raising revenues for the state, as well as the obligations of the state (according to Islamic law) to spend on the public. Thus, public finance is a sophisticated and well developed field within Islamic scholarship. Modern Islamic economics is based on these early Islamic teachings, but has also been strongly shaped by the colonization of Islamic lands, struggles for independence, and the need to respond to assertions of the superiority of Western knowledge.

2.1 The historical roots of Islamic economics

Knowledge of permanent and enduring value is that which permits us to realize our potential as human beings. This is recorded in the Quran and translated into human experience by the Prophet Muhammad⁸, as captured in the Hadeeth (records of the sayings and actions of the Prophet or his companions). Other knowledge can be relevant and important in particular historical circumstances. For example, knowledge of castle building, astrolabes and sailing ships was important in an earlier era. In contemporary times, the development of Islamic economics represents a Muslim response to the challenge created by the ascendance of the West. Increasing materialism, changing attitudes towards poverty, and other effects of the development of capitalism are aptly summarized in the transition from the Biblical "love of money is the root of all evil" to Shaw's "lack of money is the root of all evil". Since the economic system (capitalism, communism, socialism) is a major feature of Western identity, engagement requires a Muslim response in these terms. This is complicated by the fact that economics is not a high priority in Islam. As put by Mufti Shafi (1978):

There is no doubt that Islam is opposed to monasticism and considers economic activities to be permissible, desirable, and even necessary and required at times. Economic progress is desirable for men, and the earning of a *Halal* livelihood is required after the religious requirements. At the same time, it is equally self evident that in Islam the fundamental problem of man is not economic, and economic progress is not a goal or objective of life for humans.

Mufti Shafi goes on to explain that in Islam, economic activity is a means to an end, and not an end in itself. This difference in purpose is fundamental, and is the basis for all other differences between Islamic and Western views on economic affairs.. There is no doubt that many Islamic teachings relate to economic affairs, and there exists a vast literature on many aspects of economic affairs, starting from the earliest periods of Islamic history. A survey and summary of the economic thought of early Muslims is given

⁸ May Allah shower his mercy and blessings upon him.

in Sadeq and Ghazali (1992),⁹ and Islahi (2008) provides an excellent literature survey of Muslim economic thought in general. Nonetheless, economics was never considered in isolation, as a separate subject, since it is always a means to an end, and never an end in itself. Numerous specific goals or ends for economic activity will be discussed in what follows. As a broad general principle, Islamic systems in all spheres are built with the goal of promoting community feeling and cooperation among all members of society:

(Q3:103) *And hold fast, all together, by the rope which Allah (stretches out for you), and be not divided among yourselves; and remember with gratitude Allah's favour on you; for ye were enemies and He joined your hearts in love, so that by His Grace, ye became brethren;*

Other verses (Q8:62, 63) state that all the treasure in the world cannot purchase love between hearts. This prioritization of community feeling over material wealth differentiates Islamic systems from the competitive self-interest based individualistic systems at the heart of modern economic theory.

The birth of Islamic economics as we know it today can be dated to the early twentieth century. The needs of liberation movements gave a distinct shape to Islamic thought all over the Islamic world. It was necessary to argue that Islam required Muslims to struggle for freedom, and that it offered a better way of life than the dominant Western systems of capitalism and communism. This forced Muslim thinkers to delineate and distinguish Islamic socio-political and economic systems¹⁰. Although these issues have been discussed by many Muslim thinkers, two major figures devoted substantial energy and time to developing the basis and defending the need for a distinct Islamic economic system: Mohammad Baqir Al-Sadr (1961) in his book *Our Economy*, and Sayyid Abul Ala Maududi in numerous books and articles (e.g. *Economic System of Islam*, 1970). Chapra (2004) summarises this historical background and the views of Maududi, and gives citations to the latter's numerous works. Chapra also remarks on the courage it took to formulate an Islamic system and defend it against the dominant and apparently tremendously successful Western systems in the early twentieth century. Mirakhor (2005) presents a survey of trends in Islamic economics, which includes some discussion of the contributions of Baqir Al-Sadr. T. M. Aziz (1993) and Wilson (1998) have discussed at much greater length the contribution and legacy of Baqir Al-Sadr. The founders of Islamic economics (Al-Sadr, 1961; Maududi, 1947, 1970) agree that the focus of Islam is on human and spiritual development, and the purpose of an economic system is to promote justice and equity. Both believed that applications of Islamic laws and guiding principles in the economic sphere would bring advances in human welfare and be superior to Western systems for handling economic affairs, which promote only material welfare.

To summarise, it is worth putting the development of Islamic economics into a broader perspective. During the eighteenth and nineteenth centuries, European colonization of Muslim lands had destroyed functioning political, social, health and educational

⁹ Schumpeter (1974) suggests that economic thoughts did not occur to mankind during the five hundred years between the Greeks and the Renaissance – the so-called 'great gap'. Mirakhor (1983) fills this gap with the economic thought of Muslims; see also Ahghari (1991) and Ghazanfar (2003). Khan (1983, 1991, 1998) provides many more references in his annotated bibliographies.

¹⁰ There is no doubt that historical circumstances have strongly impacted on modern formulations of Islamic economics, as well as political theories. This has led some observers to the mistaken belief that these theories are additions to the corpus of Islamic beliefs – for example, Kuran (1997, p. 306) writes that "Bringing economics within the purview of religion was, then, central to Mawdudi's broader goal". In fact, economics has always been within the purview of Islam, but has never been separated out as a distinct sub-domain or isolated from spiritual and social concerns.

structures¹¹. This was considered necessary for progress since, as Lord Cromer, the British counsel in Cairo from 1883-1907, said “...as a social system, Islam has been a complete failure. Islam keeps women in a position of inferiority...it permits slavery...its general tendency is intolerance towards other faiths...” Said (1978, Introduction, part III) provides a penetrating analysis of the effects of European colonisation on the production of Western knowledge about the Orient; he writes that “All academic knowledge about India and Egypt is somehow tinged and impressed with, violated by, the gross political fact (of imperialism).”

It is now widely agreed that good institutions and public participation in and ownership of socio-political processes¹² are crucial to progress and development (broadly defined). Indigenous institutions, created and adapted to perceived public needs, had been replaced during the colonial era by alien and exploitative governance structures designed solely for the efficient extraction of revenues. Replacing these relics of the colonial era and adapting them for use in states based on Islamic principles, as well as creating new institutions in line with Islamic ideals, is a huge task, requiring both vision and the political power and energy to implement the vision. The task is further complicated by powerful vested interests, as well as European interests and fears of Islam. The failure of alien, authoritarian, and exploitative Western institutions to take root in Muslim societies has been attributed to Islam and characterised by some as backwardness (e.g. Lewis, 2003a, 2003b, but see also rebuttals by Alam (2002), Dalrymple (2004) and Hirsh (2004)). Concerted efforts are being made to co-opt and coerce Muslims into following Western agendas, with explicit encouragement to creating versions of Islam amenable to Western interests and fomenting divisions among Muslims – see, for example, Benard (2004). The struggle to find a suitable compromise between the demands of modernity and the demands of Islam is under way throughout the Islamic world, with a wide spectrum of positions being adopted by different groups. Maulana Syed Abul Hasan Ali Nadvi (1980) gives a Muslim point of view regarding this struggle, which will shape the future of the Muslim world and of which the development of Islamic economics is part.

2.2 The emergence of Islamic economics in the post-colonial era

There is widespread agreement among Muslims with the theses of Maududi and Baqir Al-Sadr that the moral imperatives embedded in an Islamic economic system differentiate it from both capitalism and communism¹³. More detailed articulation of such a system had, however, to wait until the 1970s, when several factors created a need for new economic thinking. The emergence of OPEC put a substantial amount of political power and wealth in Muslim hands. At the time, developed financial markets existed only in the West, so this newfound wealth was placed in American and European markets. However, the interest-based financial system conflicted with Islamic law, and this created a demand

¹¹ This runs counter to the belief that European colonization brought civilization to primitive cultures. The facile assumption that conquest proves superiority runs counter to historical evidence that savage tribes have often over-run more advanced civilizations. Evidence for this point of view is provided in Marglin (2007) and Mitchell (2002). Syed Hussain Ahmed Madani (1953) documents the destruction of numerous welfare and educational institutions in India and the spreading of corrupt practices among the populace due to British rule.

¹² I refrain from using the simpler word ‘democracy’, since it tends to be interpreted as elections/voting and imitation of Western political institutions.

¹³ While most Muslim authors argue for a distinct Islamic economic system, some have gone against this current. For example, Sibai (1982) argues that Islam is a variant of socialism, and advocates nationalization and other socialist economic strategies. See Mintjes (1978) for a survey of the discussions about Islamic socialism. Weber (1930) and his followers argued that Islam is fundamentally incompatible with capitalism. Rodinson (1966) argued against this view, suggesting that by creative adaptation and interpretation of Islamic law, Muslims could choose freely among economic systems.

for Islamically permissible alternatives. The seizure of USD 8 billion of Iranian assets by the USA in 1979 and subsequent similar threats have also led Muslims to seek alternatives to investment in the West. Many Islamic economists date the birth of the second wave of Islamic economics to the First International Conference on Islamic Economics held in Mecca in 1976. The papers presented at that and subsequent conferences, which rapidly multiplied, conform to the thesis of Pfeifer (1996), who argues that Islamic economics was a response to the economic problems facing many Muslims, just as Keynesian economics responded to problems created by the Great Depression and Marxian economics responded to problems created by industrialization in England. A characteristic of this second wave of Islamic economic thinking is its concern with details, and technical and operational aspects, as opposed to the general systems and global outlook of the first wave. Islahi (2008) has presented an excellent account of the history and a categorization of the different types of Islamic Economics corresponding to the characteristics of different eras.

The recent literature on Islamic economics is so vast that only a tiny percentage can be referred to here. Akram Khan (1983, 1991, 1998) has provided extensive annotated bibliographies of material in English and Urdu. I must also apologise for my lack of familiarity with the vast Arabic literature that has not been translated, as well as scattered offerings in many Islamic languages¹⁴; this may have led to significant omissions and distortions without my being aware of it. Broad overviews from different perspectives are given in Chapra (2000), Kuran (1997), Pfeifer (1996) and Issawi (1984). An early but nonetheless useful literature survey is Siddiqi (1980). Monzer Kahf has written extensively on nearly all aspects of Islamic economics (Kahf, 1991, 1995a, 1995b, 1996a, 1996b, 1998a, 1998b, 2000, 2003, 2004, undated)¹⁵. The Islamic Research and Training Institute (IRTI), a department of the Islamic Development Bank (IDB), has initiated a project to build a comprehensive web-based library of Islamic economics¹⁶.

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In the post-colonial era, Muslims have (differing degrees of) freedom to handle their economic affairs. Western methods of organizing economic affairs and Western institutions are often in conflict with Islamic laws and, more fundamentally, Islamic concepts of socio-political and economic organization. Efforts to transform these organizations and institutions have led to both theoretical and practical developments in Islamic economics. In states where Muslims have had political power and live in sufficient numbers, fully or partially Islamic systems have resulted. In other situations, Muslims have used private and market-oriented means rather than government policies to create economic institutions in conformity with Islamic law. These three situations (fully Islamic governments, a mixture of secular and Islamic institutions, and purely private market-based Islamic institutions) have led to the establishment of different types of economic institutions and are considered separately below.

Differing types of needs have led to the involvement of different types of contributors to the development of the literature. The need for articulation of an ideal Islamic system in conformity with Islamic law led to the first wave of authors, consisting of traditional scholars of Islam, who mainly have legal training in Islamic law. The need to analyse

¹⁴ Muqorobin (2008) categorizes by language 5,000 publications available at the International Islamic University of Malaysia; this provides some idea of the relative quantity of publications in different languages. Many Arabic publications and guides to the literature are available from Islamic Economics Research Center of King Abdul Aziz University, from their website: <http://islamiccenter.kau.edu.sa/english/index.htm>

¹⁵ His works are easily available from his website <http://www.monzer.kahf.com>

¹⁶ Nearly all of the IRTI/IDB publications are available for downloading from www.irtipms.org/PubAllE.asp

modern economic institutions in order to transform them in appropriate directions led to a second wave of authors trained in Western schools of economics. Practical aspects of making concrete changes in financial institutions and government regulations have led to a number of political and policy oriented writings from various sources. Kahf (2004) discusses these categories and also provides a chronology and history, as well as identifying problems arising from the multidisciplinary nature of the subject. It has been realised for some time that training in several disciplines (including both traditional Islamic law and modern economics) is needed and several institutions have been set up to meet this need. Among the largest is the Islamic Development Bank (IDB), established in 1975 to "foster the economic development and social progress of member countries and Muslim communities individually as well as jointly in accordance with the principles of *Shari'ah* i.e. Islamic Law." The Islamic Research and Training Institute (IRTI) is the academic wing of the IDB and has produced a substantial number of publications on all aspects of Islamic economics.

2.2.1 Fully Islamic governments

Any government committed to enforcing Islamic law (or the *Shari'ah*) may be considered a fully Islamic government for our present purposes in this paper. In the modern era, Iran, Saudi Arabia, Sudan, and also Afghanistan for a short period of time, might be considered fully Islamic. However, an implicit agreement by religious leaders to leave political and economic control in the hands of the Saud family, in return for enforcement of Islamic law in social, family and personal matters, has meant that the economic structures in Saudi Arabia have not been subjected to Islamic law. This situation is slowly changing in response to changes in the rest of the Islamic world. The experience of Iran in Islamizing its economic system has been discussed in Niblock and Wilson (1999) and Farhadian (2002). Some aspects of the Sudanese experience with Islamization of its economic system have been discussed by Elhiraika (2003, 2004) and Elhiraika and Ismail (2000). Movements for full Islamization of social, political and economic structures have occurred in other countries, notably Algeria, Afghanistan and Pakistan. Although these struggles have not been fully successful, they have nonetheless had substantial impacts on institutional structures.

2.2.2 Partially Islamic governments

At the global and nation-state levels, Islamic movements have generated a large amount of political literature, which seeks to persuade the public of the benefits of an Islamic system, generally defined in rather vague terms. For example, the Refah party in Turkey promised a 'just economic system' and defined it as an Islamic economic system. Numerous Islamic political parties all over the world have published platforms about how they would organize economic affairs along Islamic lines. In practice, tensions between the idealistic vision of Islam and practical necessities have led to gaps between promises and performance. Noori (1986) studied these issues in Pakistan and Iran, while Beinin (2004) analyses the performance of Islamic parties in Egypt and Turkey. To attract voters, even parties based on other ideologies have attempted to portray their economic policies as 'Islamic'. For example, the People's Party in Pakistan promoted 'Islamic communism' as part of its platform, and tracts on Islamic socialism also exist (see Mintjes, 1978; Sibai, 1982).

In many Muslim countries, demands for Islamization have led to governments creating and/or accommodating Islamic financial and other institutions. In Malaysia and Indonesia,

many Islamic financial institutions operate alongside conventional ones, with government support. Ariff (1419H/1998) and Timberg (2000) respectively discuss the Malaysian and Indonesian economic experiences. In Pakistan, demands for complete Islamization of the financial sector have been resisted by the government, and there is a move towards the Malaysian/Indonesian models of allowing both secular interest-based institutions and Islamic institutions to operate. Tahir (2007) gives some details of the progress of Islamic banking in the Muslim world, while Ayub (2007) discusses the history of Islamic banking in Pakistan.

It is worth mentioning that the struggle to establish Islamic institutions has occurred in other domains as well, influencing government policy and decisions, as well as civil society. For example, Martin Lau (2006) details the impact of Islam and Islamic law on the Pakistani legal system, which led to emergence of *Shari'a* courts (in parallel with secular ones).

2.2.3 Private sector solutions

Where Muslims are in a minority or lack political power, private and market-based solutions (which do not require governmental support) have been developed to allow financial transactions in conformity with Islamic law. While the number of such institutions is extremely large and diverse, they have not been the subject of any systematic study. A few areas in which there has been substantial activity are listed below.

There are a large number of 'Islamic' mortgage companies operating throughout the world. These are generally based on 'diminishing *musharaka*', which is an Islamic version of a rent-purchase scheme (see Bendjilali and Tariqullah Khan, 1995). There are also two listed mutual funds in the USA (AMANA growth and income), which purchase stock in companies declared to be Islamically permissible. The launch of the Dow Jones Islamic Index in 1999 was a milestone in this development. Conventional insurance has an element of gambling, which is not permissible according to most scholars of Islamic law (see Section 6.2). Accordingly, alternatives have been devised, and many companies based on Islamically permissible forms of insurance have been launched. Usmani (2000) and El-Gamal (2000) provide introductory explanations of Islamic law about banking and insurance, with references to both contemporary and older primary sources. In the private sector, many types of firms have developed innovative means to cleanse their day-to-day operations of interest-based and other un-Islamic transactions (see for example, Sitara Chemicals at <http://www.sitara.com.pk/company/finplcy.htm>). Schemes to provide Islamic microfinance and microcredit have also been launched. Sait and Lim (2005, Paper 8) give a broad overview, while Grace and Al-Zamzami (2001) discuss a case study of microcredit in Yemen. These private sector initiatives are diverse, decentralized, and uncoordinated, and to my knowledge, there has not yet been any systematic academic study of the phenomenon¹⁷.

2.2.4 Islamic economics as a response to Muslim needs

The different situations faced by Muslims require different types of solutions along Islamic lines. Muslims in control of a modern nation state need guidance on how to run a state

¹⁷ However, a collection of articles on different initiatives is available from various websites, including the Dow-Jones website at: <http://www.djindexes.com/mdsidx/index.cfm?event=showIslamicArticles> (See also <http://www.nubank.com/islamic/index.html> and <http://islamic-finance.net/elief.html>)

along Islamic lines. Traditional forms of Islamic states and the extensive legal apparatus developed by Muslims to run such states needs to be updated and modified to meet modern requirements. Kahf (1991), Siddiqui (1948) and Hasanuzzaman (1980) discuss the economic functions of an Islamic state in the light of history and Islamic law, with a view to implementation in a modern state. Tahir et al (1999) and Waqar M. Khan (2002), among others, detail concrete steps required for a transition from secular financial institutions to Islamic ones.

In the majority of Muslim states, secular and westernized elites compete with Islamic elements and prevent the formation of fully Islamic states. In other cases, non-Muslim governments may seek to accommodate Muslim minorities (India, Sri Lanka, South Africa, etc.) or Muslim governments may seek to accommodate non-Muslim minorities (Malaysia, Indonesia, etc.). In all such cases, partial government support for initiatives for Islamization and Islamic institutions is available. Muslim authors agree that the financial, political and social institutions of an Islamic state form a coordinated and integrated whole. There is some controversy about whether partial Islamization, or the introduction of Islamic institutions working within an un-Islamic framework, is feasible or desirable in an Islamic state. A minority have taken the view that the philosophy and worldview behind capitalistic institutions is antithetical to Islam (Taseen 2001, Vadillo n.d., Ansari 2000). In their view it is necessary to make radical transformations and Islamize the whole state prior to building Islamic institutions; they consider that efforts to Islamize institutions within an un-Islamic framework are counterproductive. The majority of authors have taken the point of view that gradual and step-by-step Islamization will require transitional forms in which some parts and aspects of the economy are Islamized. Books like *Introduction to Islamic Finance* by Usmani (2000) and *Islamic Banking and Finance: Theory and Practice* by M. N. Ayub (2002) spell out the technical requirements and changes in conventional banking that would be required to make it conform to Islamic law, without assuming a fully Islamic framework and other supporting Islamic institutions.

In situations where Muslims are in a minority, and government and large scale institutional support or changes in legal frameworks are not possible, rulings of Islamic law are required on what is and is not permissible for Islamic institutions and individuals operating in a non-Islamic environment. Fahim Khan (2002) provides a survey of the literature on the application of Islamic law to different types of modern economic issues.

In a broader perspective, Islamic economics can be considered part of an ongoing project for the 'Islamization of knowledge', as defined by Al-Attas (1984) and Al-Faruqi (1982). Prior to the colonization of Islamic lands, centres for religious learning (*madrassas* and *jamias* or universities) taught the basic Islamic sciences and provided education in all fields. For example, Sikand (2004) writes about *madrassas* in pre-colonial and early colonial British India:

The syllabus employed at the Nizamia madrassa, which served as a model for madrassas elsewhere, represented a blend of *naqli 'ulum* (revealed sciences), including the Quran, the hadith, *fiqh* (Islamic jurisprudence) and *tafsir* (Quranic commentary), on the one hand, and the *aqli 'ulum* (rational sciences), including Arabic language, grammar, logic, rhetoric, philosophy, astronomy, medicine, physics and mathematics, on the other.

These systems of education were eventually destroyed by colonization. For example, in British India, properties of trusts devoted to educational and health services were seized and government jobs were restricted to graduates of English-medium educational

institutions. *Madrassas* adopted creative strategies to survive, but loss of prestige, state patronage, endowments and jobs for their graduates led to substantial changes in their role and function. In particular, they retrenched to the core function of providing a religious education, abandoning the secular fields partly because of lack of resources, and partly because they could not compete with newly founded modern educational institutions. This history is available from Akram (1975), Ahmad (1953), Sikand (2004) and others.

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From the earliest colonial times, the desire to incorporate western science into the curriculum of a standard Islamic training has been tempered with the knowledge that the worldview underlying these sciences is antithetical to Islam. A penetrating analysis of the both the attractions and perils of Western science and differing Muslim attitudes is given in Kalin (2002). Nevertheless, efforts have been made, and continue to be made, to integrate Western sciences into the framework of an Islamic education, and Islamic economics is part of this effort. In concrete form, the Organization of the Islamic Conference (OIC) chartered and launched the two International Islamic Universities explicitly for this purpose at the start of the fifteenth century Hijri (1979-80 A.D.)¹⁸. In addition to these Islamic universities, and numerous other Islamic institutions that are trying to integrate Islamic and Western knowledge, some Western institutions (for example the universities of Harvard in the USA, Loughborough in the UK, and Bochum in Germany) have launched departments or programmes designed to study Islamic economics. In addition to the desire to study this new phenomenon, activities are probably motivated by a desire to benefit from the large amount of money in Muslim countries and the Muslim preference for financial services that conform to Islamic law.

¹⁸ The goals of the International Islamic University of Islamabad include "To re-construct human thought in all its forms on the foundations of Islam", while the International Islamic University of Malaysia aims to "Integrate Islamic revealed knowledge and values in all academic disciplines and educational activities".

3 Fundamentals of an Islamic economic system

(Q28:77) "But seek, with the (wealth) which Allah has bestowed on thee, the Home of the Hereafter, nor forget thy portion in this world: but do thou good, as Allah has been good to thee, and seek not (occasions for) mischief in the land: for Allah loves not those who do mischief."

As the earlier quote from Mufti Shafi (1978) indicates, an Islamic economic system is a means to an end, rather than an end in itself. A defining characteristic of capitalism is the pursuit of wealth, and the use of wealth as a yardstick to define development and progress (see, for example, Weber, 1930; Giovanni Arrighi, 1997). This limited focus has been criticized by Islamic economists. Maududi (1970), for example, writes that difficulties and complexities in understanding economics arise because

...economic problems, which form a part of the larger problems of human existence, have been separated out of the collectivity and considered in isolation. This tendency eventually grew to the extent that economic problem became the central problem of human existence. This second mistake was even larger than the first.

Many other authors criticize the simplifying assumptions of some conventional economics, especially the pre-eminence given to economic growth as both a goal and a means of achieving welfare for all. Chapra (1993), for example, writes: "mere maximization of total output cannot be the goal of a Muslim society. ... [It] ... must be accompanied by ensuring efforts directed to ... spiritual health ... justice and fair play."

Specific goals and Islamic institutions, injunctions and concrete measures designed for their realisation are detailed later. In this section, the religious starting points for Muslims' attempts to design an economic system that is compatible with Islam are outlined. These constitute a number of general principles based on Islamic teaching and have methodological implications that will also be briefly discussed. The detailed interpretation of Islamic teaching is not, however, the main focus of this paper, and so the discussion will be limited to what I consider vital for the reader to understand subsequent sections.

3.1 The Islamic view of human beings

The Islamic view of humans is dynamic and complex. It is acknowledged that greed and other base motivations exist in humans, but the essence of humanity is the possibility of not acting on these and instead choosing a higher and more spiritual mode of existence.

(Q3:14) *Fair in the eyes of men is the love of things they covet: Women and sons; Heaped-up hoards of gold and silver; horses branded (for blood and excellence); and (wealth of) cattle and well-tilled land. Such are the possessions of this world's life; but in nearness to Allah is the best of the goals.*

Islam is concerned with the transformation of human beings from followers of base desires to people concerned with achieving higher goals. It was this transformation of human beings, brought about by the training of the Prophet Muhammad (may Allah shower his blessings upon him) that revolutionized the world and changed the course of

history¹⁹. The Quran asserts that there exists tremendous potential for both good and evil within people:

Q95:4,5 Surely We created man in the best of forms. Then We reduced him to the lowest of the low

The purpose of life is to struggle for the inner spiritual transformation required to achieve the potential to be the best of the creation, superior even to the angels. This potential exists within every human being; in this way, all are equal before God. These views are in stark contrast with the conception of humans that is at the heart of modern neoclassical economic theory: in this view humans are solely motivated by selfishness and greed, and are completely indifferent to others. We have already discussed the historical origin of these views in the West, which arose from an attempt to mimic successful methodology in physics. Humans imbued with Islamic values have been labelled *homo islamicus* and contrasted with the *homo economicus* of neoclassical economic theory by several authors – see for example, Hosseini (1992), Kafh (1996b) and Mortazavi (2004).

We have suggested above that neo-classical economic theory is based on the assumption of competition between self-interested individuals, while Islamic economics is based on advocacy of cooperation within a community with shared goals. An empirical approach requires us to ask which of the two theories is more accurate empirically. “Are people selfish or cooperative?” is the title of a section in a literature survey of experiments on behaviour with respect to public goods by Ledyard (1995). He concludes that the experiments show that people are neither²⁰. Instead, a small minority of people are unfailingly cooperative, a greater number are invariably selfish, while a majority exhibit different behaviour in different circumstances, throwing doubt on one of the key assumptions of neoclassical economics.

Islam takes a clear and definite stand on this issue, and suggests that the question itself is not well-posed. Every human being has the capability of being a saint, but even saints have base impulses and the possibility of succumbing to temptation. Furthermore, human beings are essentially free, so their past does not determine the future: the greatest of sinners can choose to become a saint, and vice versa. Due to this plasticity and the essential freedom of human behaviour, the scientific method of observation and theory construction is not well suited to the study of society. Instead, since human behaviour responds to expectations and social norms, we are free to choose the type of society in which we wish to live. If we promote that idea that human beings are naturally selfish, and that such selfish behaviour leads to the best social outcomes, human beings will learn to behave selfishly²¹. In fact, Islam teaches us that all children are born in Islam, which is the religion of nature (*deen-ul-fitrah*), but that childhood training causes them to deviate from the ‘natural path’. This does not mean that children are naturally cooperative and generous; rather, that the recognition and appreciation of virtuous behaviour is built into their hearts. This makes it easy to train them to be good.

¹⁹ The Arabs went from being near-savages, who buried their infant daughters alive and killed each other for trivialities, to models of civilized behaviour for all times. Hart (2000) ranks the Prophet as the single most influential man in all of human history.

²⁰ Contrary to Adam Smith, Marshall (cited in Ali Khan, 2004) thought that businessmen were not primarily motivated by the ‘sordid and ignoble’ love of money.

²¹ A number of articles showing greater selfishness on the part of economists, who are trained to think of selfishness as socially beneficial, have been published; see Kirchgässner (2005) for a survey. Perhaps the strongest evidence of the impact of economic training is furnished by responses to behaviours observed in Experimental Economics. Since the most fundamental axiom of economic thought, ‘people prefer more money to less’, is routinely violated in many situations, economists cannot help but be puzzled by observed behaviour (see Camerer, 2003, p 60). No one else finds it surprising.

Use of the terms 'human capital', human resource development and development of job skills and productivity as a means to progress highlight the currently dominant view of humans as an input to the production process. This contrasts with the Islamic view that development of human beings is the goal and production of resources etc. is only useful to the extent that it is a means to this goal; see for example, El-Ghazali (1994).

3.2 Wealth and freedom

This concern with higher goals determines how the ends to be achieved by the use of economic means are defined. A clear and comprehensive statement is provided by the Quran in verse Q28:77 cited above: Wealth is to be used to pursue the home of the hereafter (by doing things that will please Allah). Since wealth has been given to us as a gift from Allah, we should also be generous in giving to others. These principles resemble those promoted by other religions, although they stand in stark contrast to conventional economics. Since property is a trust from Allah, we cannot do with it as we please. Those who do not believe this, in contrast, are quoted as asserting that they have earned their wealth through their own efforts and therefore have a right to do as they please with it:

(Q 11:87) *They said: "O Shu'aib! Does thy religion command thee that ... we leave off doing what we like with our property? "*

In particular, pursuit of luxurious lifestyles and the pleasures of this world is not the object of wealth: the Quran condemns both the pursuit of idle desires (Q45:23) and emulation of luxurious lifestyles (Q3:196). The modes of behaviour encouraged by Quranic injunctions are not primarily for the economic welfare of society; that is a fringe benefit. Rather, behaving in these ways will bring people closer to God, lead to spiritual development, and develop the potential within them to be better than the angels.

Dissatisfaction with the results of the unconstrained pursuit of material wealth has led to substantial reconsideration of the idea of development in the recent past. While many different approaches have emerged, all emphasize the role and importance of human beings (relative to material wealth or capital) in the development process. Putting an abstraction over material goals, *Development as Freedom* by Sen (1999) is perhaps the most radical departure from conventional views amongst economists. Sen advocates evaluating development in terms of human capacities and freedoms, which has some resemblance to Muslim views. However, a major difference is pointed out by Ali (1931) in *Tareequl-Qalander*; unlike Sen, he holds that real freedom is only given to people who have freed themselves from base selfish desires – others are just slaves to their egos/desires and are not really free at all²².

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3.3 Contrasting principles of Islamic and neoclassical economics

While other Western disciplines and heterodox economists have broader views, neoclassical economists base their analysis of markets on cut-throat competition between selfish individuals. At the heart of Islam is the promotion of cooperation between individuals who can be motivated to be generous. This contrast can be displayed along three dimensions as principles which differentiate Islamic and neoclassical economics.

²² Similar ideas occur in all religious traditions; see Wilson (1991). For example, the Bhagavad Gita compares a man controlled by his desires to a carriage controlled by the horses instead of the driver.

1. In general, Islam stresses co-operation and harmony, and the spending of wealth and materials to achieve this goal. This contrasts with the neoliberal economic vision of the free market as a jungle where enterprises and people compete to achieve maximum wealth. Nevertheless, although the dominant views have favoured individualism, competition and selfishness, many well-known economists have wrestled with the conflict between these views and the value of social interests, community and cooperation (see Ali Khan, 2004, for references and discussion).
2. Social interests take precedence over personal ones. The commons dispute in England was resolved by enclosures, favouring private interests over public, and the rich over the poor. The same dispute was resolved in the opposite way in the early Islamic era, by banning rich people with large herds from use of the commons for grazing (see Zarqa, 1995; Hasanuzzaman, 1981; Mortazavi, 2004).
3. Intentions for actions in all domains, including the economic, are crucial. In contrast, Western economists distrust internal states and strongly prefer to base their theories on observable behaviour. Positivism, as interpreted by economists, suggests that only observable actions matter; the internal states of satisfaction and motivations do not. For example, economists rely on observed choices, rather than unobserved preferences, as a guide to consumer behaviour.

I will show how these contrasts differentiate between Islamic and neoclassical analyses of economic behaviour in the many different domains to be discussed later.

3.4 Detached observation vs. passionate engagement

Reuben (1996) has described how conflicts between religion and science, as well as changing ideas about the nature of science, led to the abandonment of the moral mission of building character in American universities in the early twentieth century. In the process, social scientists abandoned the role of activists and reformers working to bring about a better world in favour of the detached observer role of the Baconian scientist. Unfortunately, as Nelson (2001) and many other authors have remarked, social science is relevant only to the extent that it is concerned with human goals and values. The effort to make social science value-free merely leads to the masking of political and ethical commitments under various guises.

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Because they have been hidden beneath apparently sterile mathematics, the values on which neoclassical economics is based have not been subjected to examination. To evaluate the effects of economic actions, neoclassical economists refer to a fairytale world populated entirely by cold, calculating and callous people with no social feelings. In this world, everyone is perfectly informed about all possibilities; there are no transaction, communication or transportation costs; and everyone calculates, to the last penny, the actions which will be most beneficial to their selfish interests. Economic policies are evaluated solely in terms of their effects on the wealth of these imaginary individuals living in this never-never land. In social and political arenas, the wonders of this imaginary world are idealized and promoted, and aggressive actions to change the world to bring it closer to this ideal have been advocated and undertaken. The realization that it will never actually be achieved does not discourage followers of this economic ideology from attempting to bring the world closer to their dreams.

Because of the claims to positive status of western economics, the issue of whether Islamic economics is positive or normative is often debated in the literature. In light of the earlier discussion, I would assert that the answer is neither – Islamic economics is transformative. It seeks to change society, and all individuals within that society, towards an ideal. The previous paragraph responds to the charge that Islamic economics is ‘utopian’ by showing that neoclassical economics is dystopian. In addition, history shows us that utopians and dreamers have often had a tremendous impact on human lives²³. Since Islamic ideals have been realised in the past, Islamic views about society are not ‘utopian’ in the sense of being unrealistic. For example, Lopez (1976) documents the existence of a vast and prosperous global network of commerce guided by Islamic law in the heyday of the Islamic empire.

Compassion and concern for all human beings and passionate engagement in improving their lot is a central teaching of Islam. The struggle to improve ourselves and our societies, and to overcome our base desires, is the greater Jihad (while war is the lesser). Furthermore, it is part of Islamic teaching that it is this struggle to change the world in ways pleasing to God that will generate knowledge: “Q29:69 *As for those who strive in Us, We surely guide them to Our paths, and lo! Allah is with the good.*”

The idea that Islamic economics is transformative resembles the Marxist concept of *praxis* – Marxists do not seek to study the world but to change it. There is a key difference, however. Muslims struggle for justice, equitable economic outcomes, etc. because such struggles will bring about an inner spiritual transformation. Thus the goal of the struggle is spiritual rather than material. Marxists emphasize material outcomes to the extent that they suggest that ideals, philosophies, and visions are conditioned by the material prospects of humanity. Islam denies this emphatically, and tells us of the primacy and dominance of the spiritual over the material world. Human history bears witness to this primacy, as demonstrated by numerous instances of men with vision who have changed the world without any apparent material means of doing so. A prime example is that of our Prophet Mohammad himself (may the peace and blessing of Allah be upon him), who changed the course of human history solely by inspiring the people of the Arabian desert with a grand vision, without bringing about any change in the material means at their disposal.

For Muslims, Islamic law, known as the *Shari'ah*, and the accompanying apparatus for deriving laws (*fiqh*) from source materials, is the source of guidance for translating principles into practice and provides a framework within which all activity, economic and other, should take place. The overall framework for Islamic economics that is provided by Islamic law is discussed in Section 4 below.

²³ An important utopian was Karl Marx, whose vision of a classless society where everybody would receive what he or she needed from a benevolent state, and labourers would receive dignity and respect, motivated and changed the lives of millions in the last century. Ironically, this provides a powerful illustration of the power of ideas, visions, and philosophies to dramatically change the material world, contrary to one of his own central theses.

4 The framework: *Shari'ah* or Islamic law

Q7:157 [The Prophet] who will enjoin upon them the doing of what is right and forbid them the doing of what is wrong, and make lawful to them the good things of life and forbid them the bad things, and lift from them their burdens and the shackles that were upon them

Although the nearest translation of the *Shari'a* is 'Islamic law', this is somewhat misleading, since the *Shari'a* covers all aspects of life from details of personal hygiene, to social organisation, permissible and impermissible commercial transactions, rules for spiritual and emotional conduct, etc. An accessible introduction can be found in *Theories of Islamic Law: The Methodology of Ijtihad* by Nyazee (1994). Among the rules of the *Shari'a*, many relate to economic life. Economic teachings from the Quran have been collected in Maududi (1963, 1969) and more recently by Hasanuzzaman (1999). The second source of Islamic law is the *Sunnah*, or reported sayings or activity of the Prophet (s.a.w.) or his companions. These have been gathered in *Economic Teachings of Prophet Muhammad*, by Akram Khan (1989). *Fiqh* is the name for the process of deriving rulings on situations not directly covered from these basic sources of Islamic law. Fahim Khan (2002) discusses *fiqh* foundations of the theory of Islamic economics. In this section, we will discuss only those aspects of Islamic law that relate to collective economic activity, at the state or social level. Teachings related to individual behaviour will be discussed separately, in Section 7.

4.1 Objectives of the *Shari'a*

The primary sources of *Shari'a* are the Quran and Sunnah. These contain rules and recommendations on all aspects of individual and social life, dividing actions into three broad categories: *farz* (compulsory), *halal* (permissible), and *haram* (prohibited). Within each category there are refinements, subtleties and complexities; for example within the *halal* category, there are gradations from highly recommended to highly disliked. The Quran states that Islam is a complete religion; hence, it is axiomatic that all human actions fall within the scope of Islam. Extending the application of Islamic law to a new situation is called *ijtihad*. Rules by which *ijtihad* is done (analogy to similar situations, consensus, etc.) are called *fiqh*. Over the centuries, a large body of rulings covering applications of Islamic law to different situations encountered in the historical experience of Muslims has emerged. I will refer to the collectivity of these rulings as the Islamic tradition. This tradition covers a broad range of issues, with sharp conflicts over some, and a wide range of positions adopted by different groups over others. Despite diversity and conflicts, the tradition as a whole forms a harmonious collection of rules broadly consonant with the spirit of Islam for a wide range of situations faced by humans both individually and collectively. Islam also has a tradition of tolerance for dissent, so that conflicting opinions may simultaneously be held to be acceptable Islamic solutions to a given problem. Walbridge (2002) discusses this tradition of tolerance and its significance in Islamic history. Deeper and more extensive discussions based on source materials are given in Zakariyya (1938) and Waliullah (1750, conclusion of Part I).

Engaging in the struggle (*jihad*) to bring justice and good to the world, as prescribed by the *Shari'a*, will bring us closer to God, and lead to spiritual development, realization of

the human potential within us, and an increase in knowledge. Islamic law covers both external and internal actions. For example, to be acceptable, the external act of giving money in charity must be accompanied by the intention of pleasing God by doing so. The intention to be praised for generosity, or the feeling of superiority or contempt for the poor, invalidates the act. This tension between the visible action and the invisible intent has played an important role in many aspects of Islamic history. The *ulama*, or religious scholars, have traditionally been concerned with external aspects, or the form, and have been content to leave the invisible intentions to God. In contrast Sufis have focused on the desired conditions of the heart or the spirit, sometimes to the neglect of form. These two groups have often been at odds with each other²⁴, although there have also been many individuals who have combined the best of both traditions. Islamic history shows that exclusive focus on one or the other leads to an imbalance and harmful outcomes.

The complexity of modern economies, and of modern life in general, has led to many situations not covered by the tradition. Thus *ijtihad* to cover these new complexities of economic life is a central issue in Islamic economics (and also in devising a suitable Muslim response to modernity in general). Appropriate methods for *ijtihad* continue to be a source of substantial discussion and controversy among Muslims. Modernist Muslims feel that the traditional rules of *fiqh* are not adequate to cope with current complexities, and ask for freedom to reinterpret source materials so as to creatively adapt them to modern conditions (instead of being bound by traditional rulings; i.e. Siddiqi, 2004a). Traditionalists feel that existing *fiqh* is adequate to cope with new situations, and feel that excessive freedom would amount to throwing out Islamic law altogether and caving in to modernity (Iftikhar Zaman, 1985). Yousri (2004) advocates a careful middle ground.

In a seminal work, *Shatibi's Philosophy of Islamic Law*, Masud (1995) has proposed a middle way that remains within the Islamic tradition while allowing for the greater flexibility demanded by modernists. Shatibi was an Islamic scholar in Muslim Spain who lived in a period of rapidly changing economic and political conditions. Finding traditional formulations of *fiqh* inadequate, he analysed Islamic law to distil the underlying philosophy of the law. Shatibi notes that it is universally agreed that the *Shari'ah* is not an arbitrary collection of rules, but rather is designed to promote both the material and spiritual welfare of human beings in the best possible way. Using the existing tradition to analyse this broad goal, one can distil several specific objectives aimed at by the *Shari'ah* via a logical process. These objectives include the preservation of life and property, and the welfare of descendants. In effect, Shatibi adds to traditional *fiqh* an additional method that may be used to extend Islamic law to new situations.

By utilising the objectives of Islamic law, in conjunction with more specific and precise rulings of the *Shari'ah*, one can derive many principles for Islamic economics. For example, we would not be able to find analogues for fiscal and monetary policy in Islamic source materials, putting these issues outside the scope of Islamic law – at least according to traditional rules of *fiqh*. However, we may argue on the basis of the source materials that the Prophet facilitated trade and business in many ways, and took active steps to provide a means of earning a living to the unemployed. If we conclude that reducing unemployment is an objective of the *Shari'ah*, then we may deduce that fiscal and monetary policy to achieve this goal is recommendable according to Islamic law. In a similar way, one can argue that price stabilization via monetary policy falls within the ambit of Islamic law. This methodology has been advocated by numerous scholars in

²⁴ Masud (1995) has described, *inter alia*, the conflict between the Sufis and the *ulama* in Islamic Spain.

Islamic economics and elsewhere (for example Chapra, 1985; Siddiqui, 2004a). In the remainder of this section, the Islamic law with respect to property, business and labour is discussed.

4.2 Property rights

One of the major disputes between capitalism and communism was over the issue of whether the means of production should be privately or publicly owned. Accordingly, early writers on Islamic economics spent much time delineating an Islamic theory of property rights and differentiating it from capitalist and communist theories. Siddiqi (1980) gives a succinct summary and essential references. Maududi (1947, 1970) argues that capitalism leads to increasing concentration of wealth in the hands of the owners of the means of production, which is harmful to society and against Islamic principles.

Communism, however, does not provide a solution, since government ownership in practice also turns out to be ownership by a small or limited group of people – and in practice these are often more tyrannical than private capitalists, who do not control the government. Islam provides a solution by allowing private property but ensuring socially responsible behaviour on the part of owners of excess wealth, by means of a number of mechanisms. Similar arguments have been formulated by a large number of writers: Akram Khan (1983, 1991, 1998), in his extensive bibliographies, cites many sources that systematically compare different economic systems to Islam.

Since the end of the Cold War, Islamic economists have discussed many other dimensions with respect to which Islamic concepts of property differ from typical Western ones, and the difference this makes for many socio-economic problems. Kahl (1998a) and Gulaid (1991) give detailed treatments²⁵ and further references. In work commissioned by UN-Habitat, Sait and Lim (2006) explore Islamic concepts of rights to land, as a means of providing secure access to land for the poor. They find that Islamic property concepts form a sophisticated alternative to prevalent international norms (Sait and Lim, 2005, Paper 1, p. 8):

Islam conceives of all property as a sacred trust but promotes private ownership with a re-distributive ethos. Engagement with Islamic dimensions of land may potentially support land rights initiatives in Muslim societies and has implications for programmes relating to land administration, land registration, urban planning and environmental sustainability.

We now elaborate on this brief but accurate sketch. While all of creation is originally and forever the property of God, He created it for the benefit of human beings. People who utilize property to create benefits become entitled to ownership, creating a type of private property. This private property is both a 'trust' from God, and a test, a conception that leads to a philosophy of property substantially different from current Western notions²⁶. Since property is a trust, the owner must utilize the property in ways conducive to the common interest. For example, the property should not be destroyed or used in ways that

²⁵ Property rights do not receive much attention in conventional economic literature, since the idea of private property is accepted by all. See, however, Coase (1960) and related literature and also de Soto (2000), who argues that property rights are the key to the success of capitalism.

²⁶ The theory of property rights in Islamic law is substantially different from Western theories. The European history of conquests, revolutions, and appropriations and seizures of property and subsequent reversions, led to the development of philosophies that sought to rationalize, justify or modify the existing structures of property rights; see, for example, the article on property in Wikipedia for a brief summary of this history, different schools of thought and further references.

cause harm to the public. The idea that legitimate ownership gives a person the right to do as he or she pleases with property is specifically and explicitly condemned in the Quran (Q11:87, cited earlier). Similarly, property in excess of needs is regarded as a test, to see if human beings will use it for the welfare of others, or for selfish/harmful purposes (Q68:17-27 describes people whose garden was destroyed because they wanted to avoid giving from it to the poor). There is strong encouragement to spend excess money on social welfare and equally strong discouragement of accumulation and hoarding (which contrasts with the 'endless accumulation' encouraged in capitalistic societies). These basics of the Islamic theory of property are available in substantially greater detail from numerous sources; see for example Kahl (1998a), Taseen (1998) or Sait and Lim (2006).

The fundamental Islamic concepts of property rights outlined above have far-ranging ethical and moral consequences. Since the world has been created for the benefit of people, certain types of natural resources cannot be owned privately, because private ownership would deprive the public of the intended benefit. Most Islamic scholars hold that common lands, forests, lakes, rivers and minerals (including oil) fall into this category. The government must hold such public property in trust and devise mechanisms to allow the entire public to benefit from the property. As an example, water is a public resource which is frequently and increasingly a subject of international disputes. *Water Management in Islam* by Faruqui et al (2001) provides a comparison of Islamic law with international laws and current approaches²⁷. These issues relate closely to ideas of sustainable development, which are discussed in Section 6.5 below²⁸.

A major source of injustice and oppression is concentration of wealth, often in the form of land. There are large landholdings in many Muslim states, sometimes resulting from (possibly unjust) land grants from colonizers, resulting in an extensive debate about property rights and limitations in Islamic law. Hosseini (1988) has provided a literature review in the context of contemporary Iran. Mufti Shafi (1979) discusses both the theory and the legitimacy of property ownership in India and Pakistan in the light of historical circumstances. The majority opinion in these discussions is that there are no limits on private property ownership, but that the state can repossess lands when required in the interests of social justice – for example, if they were acquired unjustly, or are needed for urgent and pressing social needs of a deserving population. Siddiqi (1980) outlines the major positions taken in this debate²⁹. In the context of providing for the basic human right of secure access to property and housing, Sait and Lim (2006) study the role of Islamic law in Muslim areas. They find that it has the potential for empowering the needy, and for providing culturally sensitive solutions to many problems of access, security and tenure of landholdings. They also find that Muslims are constructively engaged in the process of creatively adapting Islamic law to deal with modern problems.

The confidence that Western models provide ideal solutions to social, political, and economic problems has often led to a disregard of traditional patterns. A foreign expert did not need to know anything about local conditions and traditions, since these were merely obstacles to progress, defined as the adoption of Western models (see Mitchell, 2002). Repeated failures of this approach, strong local resistance to imposed and arbitrary interference by outsiders, and other aspects of changing socio-political

²⁷ The website of the International Development Resource Center also provides a large bibliography on the topic: http://www.idrc.ca/en/ev-9425-201-1-DO_TOPIC.html

²⁸ Iqbal and Mirakhor (2005) have argued that the Islamic idea that the right to property derives from making it useful leads naturally to a stakeholder model of the firm.

²⁹ He also lists 18 references (numbers 224 to 242).

conditions have led to revisions and rethinking. It has come to be appreciated that traditions emerge from complex interactions of religious ideals, cultural norms, historical and political circumstances, and often embody solutions to a host of local problems based on historical experience. Thus in the contemporary context, Sait and Lim (2005, Paper 2) write that

..land tenure concepts, categorisations and arrangements within the Islamic world are multi-faceted, generally distinctive and certainly varied. This paper explores the socio-historical context and development of Islamic land tenure regimes leading to the 'web of tenure' in contemporary Muslim societies. An appreciation of the historical context of land tenure in Muslim societies and the range of land tenure forms contributes towards development of authentic and innovative strategies for enhancing access to land and land rights.

4.3 Islamic rules of business

Islamic laws about permissible transactions for trade, transfer of property and the ethical conduct of business are quite detailed and form one of the strengths of Islamic economics. Explicit orders to fulfil contractual obligations, recommendations to write down contracts, and exhortations to witnesses to testify faithfully provide the basis on which the Islamic rules are built. *Business Ethics in Islam* by Ahmad (1995) provides a comprehensive discussion relating practical aspects of business ethics to the spiritual goals of Islam, while Pomeranz (1995) contains a brief discussion. The spiritual aspects of business are covered very well in Zakariyya (1993). The Quranic verse below clearly specifies a concern for fairness and justice over and above the idea that mutual consent of both parties is sufficient to legitimise a trade:

Q4:29 O You who believe! Do not devour one another's possessions wrongfully - not even by way of trade based on mutual agreement

Ansari and Arshad (2006) provide a comparative study, with a detailed account of conventional capitalist business ethics and how they relate to the emergence of capitalism and associated philosophies in European history.

A key difference between Islamic and Western business ethics, which lies at the heart of the matter, may be summarized as follows. In some European conceptions, morality is viewed as instrumental to the procurement of 'freedom' for individuals; freedom is also represented by wealth (which gives the individual freedom to pursue his or her desires). More crudely, "good ethics is good business". In contrast, moral behaviour or the pursuit of virtue is the goal of an Islamic society, and the conduct of business is also subordinated to this goal. In Islam, the value of any action is judged by its intention. The dramatic contrast between the Islamic view and a western secular view may be illustrated by the following Hadeeth:

A wealthy man will be called to account for his deeds on the day of Judgement. He will say that I spent (wealth given by You) in all the ways that are pleasing to You. Allah will say to him; 'You lie. You spent the wealth so that you may be called 'Generous' (or 'Virtuous' or 'Charitable'). You were so called (and there is no reward for you here). Then the man will be sent to the Hellfire. Sahih Muslim, Book 3, Chapter 33: Al-Amarah, Hadeeth 152.

Adopting integrity, supporting charitable causes and engaging in social welfare as a means of enhancing company reputation and hence favourably impacting on that business's bottom line is explicitly condemned in Islamic teachings. Virtue must not be

subordinated to making a profit. This is also logical, since if morality is seen as a means of making money, then immoral behaviour will be preferred if it leads to more money. This tendency can be illustrated by the actual ethical practices of some Western businesses. For example, after learning that design defects in the Ford Pinto would lead to deaths by burning in rear-end collisions, the Ford company calculated that the costs of a safety recall would be more than the projected monetary value of death and dismemberment.

Islamic law as it relates to business is summarized in Mansoori (2005) and Nyazee (1997, 1998). Akram Khan (1998, section 51:20) gives an annotated bibliography of about twenty articles related to business organization and specific types of contracts within the framework of Islamic law (*ijarah*, hire-purchase, instalment sales, *morabaha*, *modaraba*, etc.). One of the key principles is that transactions must be just, fair and equitable to both parties. One consequence is that transactions with *gharar* (a large amount of uncertainty or ambiguity) are prohibited; Al-Dareer (1997) gives an extensive discussion of this concept and its applications. For example, the sale of drilling rights for oil in locations where there is large amount of uncertainty about the quantity of oil available is not permissible in Islamic law³⁰. Speculation, gambling and lotteries are not permissible for the same reason (see Siddiqui, 1980, p 241, for a brief discussion and references to Islamic law sources). The majority opinion is that insurance falls into the same category (see Atiquzzafar Khan, 2005). However, in view of the economic utility of insurance, a minority view such a contract as acceptable within Islamic law. Others have tried to devise alternatives to insurance that would comply with Islamic law. This has been given the name of *takaful*, and will be discussed in Section 6.2 below.

A major area of difference between Islamic and conventional economics is the prohibition of interest. Payment of extra money to owners of funds is unjust, since it does not reward any productive activity. There is an enormous amount of literature on this issue. Siddiqi (2004b) gives a recent survey and lists references. The debate on the exact scope of the Islamic injunction and whether or not it applies to modern commercial interest has been resolved decisively in favour of the orthodox view that it does apply; this contrasts with Europe, where the same debate occurred and was resolved in the opposite manner – see *God and the Moneylenders: Usury and Law in Early Modern England* by Norman Jones (1989). The text of a judgement banning commercial interest written by the Shariat Appellate Bench of the Supreme Court of Pakistan reviews and rebuts all the major arguments in favour of interest (Usmani, 1999).

Another important set of writings addresses the issue of how to create Islamic banks that function without interest. Ayub (2002) and Zaher and Hassan (2001) provide extensive surveys. The key concept is that lenders must participate in the risks of business, in order to earn a reward. Thus collateral for business loans cannot be seized in the event of business failure – that is, Shylock cannot get his pound of flesh if the ships of Antonio sink. In the literature, the technical aspects of Islamic law, conventional banking functions, creation of suitable financial instruments, etc. tend to overwhelm the main point, which is that Islamic laws and institutions are designed not to make profits but to promote moral and spiritual growth. This aspect is discussed by Sait and Lim (2006), Faridi (1414H/1994), Naylor (2007), Sachedina (n.d.) and others. Because of the conflict between Islamic spiritual teachings and the risk-free profit-making attitudes of modern banks, some Muslims hold that the two cannot be reconciled (for example, Vadillo, n.d.; Taseen, 2001; Ansari, 2000).

³⁰ Such sales led to the coining of the term 'winner's curse', see Capen et al (1971). Also see Kagel and Roth (1995, Chapter 7) for a survey and update.

While commercial loans can be handled relatively easily, avoiding interest in microfinance, consumer loans, mortgages, government projects and foreign debt requires different methods. Each must be dealt with separately. Beginnings have been made in all. The potential for further work is reflected in the following comment about Islamic microfinance, from Sait and Lim (2005, Paper 7):

Islamic jurisprudence (*fiqh*), with its emphasis upon partnership and a concern for community welfare, together with the expansion in Islamic banking and microfinance, has the ability to respond creatively to the needs of the urban poor.

The term 'financial engineering' has been coined to deal with the issue of devising suitable financial instruments that cater to a specific need while conforming to Islamic law - see Tariqullah Khan and Munawar Iqbal (2005), and also Rosly (2005), for illustrations of the process for a wide range of financial transactions.

Islamic law encourages spending on the poor and disadvantaged, based on the principle that money that is not required to satisfy immediate needs should be spent on socially useful purposes (and not saved or used to make more money). This is urged in numerous verses of the Quran and traditions from the Prophet, for example Q2:219
...*They ask thee how much they are to spend; Say: "What is beyond your needs."*" This has implications for lending practices. Thus the *Shari'ah* encourages giving loans to the needy, not pressing for repayment, giving extra time or waiving the loan when needed. All these measures are designed to develop sympathy for those in need and a spirit of cooperation in society (see Mufti Shafi, 1978, part 2, sections 10, 18, 19). In contrast, interest-based loans based on collateral insulate the lender from the borrower, allowing the impersonal, self-interest based transactions which are the basis of the capitalist system³¹. One can use financial engineering to replace interest with *Shari'ah* compliant service charges, achieving conformity in form, but not in spirit, to Islamic law. The quest to find suitable compromises which preserve the spirit of Islamic law while being practicable in a society of ordinary human beings (not saints) is currently being carried out on many different fronts in all Islamic societies.

4.4 Labour

Azid (2005) surveys Islamic views of labour, while Egami (1990) and Rahman (1995) discuss labour as worship, and suggest how such a view of labour can create meaning and motivation for work, in contrast with the alienation and anomie in the capitalist system. Pfeifer (2006) also provides a comprehensive survey of Islamic labour laws and how they have impacted on recent developments in the Muslim world. She finds that Islamic rules about labour and how they have played out in Egypt, Pakistan and Saudi Arabia have been influenced by the Islamic vision of society as a cooperative enterprise. This contrasts with the competitive conception at the heart of the modern Western economics. Manicas (1989) has argued that the transition in the West from a cooperative ideology (which he terms *polis*) to a competitive one (termed *societas*) is one of the key transitions of modernity.

As in all spheres of human relations, Islamic laws about labour are structured as interlocking sets of complementary rights and responsibilities. The right of an individual to receive aid from society in times of need derives from the person's responsibility to do the best to provide for him or herself (Said, 1972; Taseen, 1998). The Islamic work ethic is

³¹ For this same discussion in the historical context of the widespread adoption of interest in Christian societies, see *The Idea of Usury: From Universal Brotherhood to Universal Otherhood* by Nelson (1969).

based on the idea that taking the property of another unjustly is not permissible. A worker who shirks on the job earns a wage that is not justified, and this is *haram*. This motivation for work is different from Weber's (1930) Protestant work ethic. Workers should be treated with dignity and respect, and equality maintained between employers and employees in terms of their social status (in particular, clothing, housing and food). In contrast, in capitalist societies, an employer generally has a higher status than workers, while in critiques of capitalism, the capitalist is regarded as an exploiter who receives a financial reward for no work. Islamic theory sees employer and employee as engaged in a cooperative enterprise, doing different types of work but being accorded equal respect – that is, entrepreneurial skills receive due recognition in Islam, but are not given primacy. There is great emphasis on just treatment of workers, paying them on time, not overworking or exploiting them, and not mistreating them in any way. Working conditions should be safe from accidents and not damaging to the health of workers. There is general agreement on these minimal rights of labourers, while some modern authors have found in Islamic teachings a more extensive set of labourers' rights, including vocational training and many other benefits. However, these are disputed. Abdel Aziz (1992) has argued that social justice requires hiring the most competent worker, even more so if that person is from a minority or disadvantaged group.

There is also a clear basis in Islam for profit-sharing schemes, although there is some dispute as to the extent of sharing required. Some have argued (for example, Iqbal and Mirakhor, 2005) that labour-owned firms would express the spirit of Islam, while others suggest that more flexibility in terms of the preferred model for business organization is permissible. While there is dispute on details, there is no dispute on the principle that Islamic ideals of justice and cooperation require a firm to share its good times with its workers, just as it calls upon workers to make sacrifices during bad times.

The first wife of the Prophet was a businesswoman. Throughout Islamic history, many Muslim women have owned property and have had the right to earn money. Islamic law also gives them the right to inherit. These rights became available to European women only relatively recently. Iran has recently passed a law entitling women to compensation for work done at home (childcare, cooking, etc.) – the husband is required to make such a payment in the case of divorce. This is based on the example of the Prophet, who used to do housework, and Islamic law, which places responsibility for childcare and housework on the husband, though some religious scholars have disputed the Iranian interpretation.

Pfeifer (2006) reviews the material discussed in this section, and provides a detailed study of how theories in the realm of labour laws and the treatment of labour have played out in practice in Egypt, Saudi Arabia and Pakistan. As usual in such studies, she finds that practices are conditioned by the historical and cultural context and political considerations, as well as Islamic legal theory (which is flexible and can be adapted to different purposes). Because pragmatic considerations substantially constrain idealistic visions, both Muslim and non-Muslim cynics have argued that practice is determined by the material realities, while visions, ideals and philosophies merely serve as window dressing. However, Pfeifer's earlier paper (2001) shows that Islamic firms in Egypt offer significantly higher wages (and have lower profits) than comparable non-Islamic firms, which have higher profits and lower wage shares. This and numerous other instances show that ideals influence practices, even though pragmatic considerations and human failings may prevent a complete realization.

5 Islamic states

Q22:41 (Allah will help) Those who, if We give them power in the land, establish regular prayer and give regular charity, enjoin the right and forbid wrong.

The defining characteristic of an Islamic government is its subordination to the *Shari'a* or Islamic law. All principles of government to be discussed below derive from these laws, as well as historical examples of their implementation by Islamic states. A government cannot legislate in areas where the *Shari'a* has provided laws³². These areas include inheritance, property rights (which also bear on taxation), certain types of criminal law, etc. In other areas where the *Shari'a* is silent, or else has laid down only general guidelines, the state may legislate and operate within prescribed guidelines. Citizens can (and are required by Islamic law to) refuse to obey the government in matters which are against Islamic law – obedience to God supersedes obedience to kings³³. The judiciary, which (in ambiguous cases) decides what is and is not against the Islamic law, is independent of the executive body, and plays an extremely important role because of this status³⁴. An essential feature to keep in mind, stressed by many authors, is that an Islamic state is an effort to realise the spiritual by material means through human organisation. For example, an early Islamic 'mirror for princes' – *The Wisdom that Conduces to Royal Glory* by Yusuf Hajib (ca 1070) – features a dialogue between a worldly-wise man and an ascetic, and shows how to harmonize worldly wisdom with spiritual goals. Below we discuss some of the economic functions of the Islamic state, as mandated by Islamic law, including its political organization, public finance, the judicial system, and economic security and welfare.

5.1 Political structure

Since an Islamic state came into existence during the lifetime of the Prophet (s.a.w.), Islamic theory of the state is very well developed. *The History of Islamic Political Thought: From the Prophet to the Present* by Antony Black (2001) provides a comprehensive survey.

5.1.1 Principles

³² This contrasts with modern European conceptions, according to which a government is responsible for creating and enforcing a 'social contract', which may consist of any set of mutually agreed upon rules. Hegel, building on political theories initiated by Machiavelli, argued that since a government is responsible for creating and maintaining the law, it is outside the law and not subject to it. Such a rationale for political authority was responsible for the extraordinary cruelty of the fascist states – see Manicas (1989) and also Harrington (1985) *Politics at God's Funeral*.

³³ Note the implication that in an Islamic state, no one is justified in implementing a cruel and unjust policy (such as burning of the Jews) on the grounds that 'I was just carrying out orders' – for the full import of this, see Arendt's (2006) *Eichmann in Jerusalem: A Report on the Banality of Evil*.

³⁴ Rulings by Islamic scholars on the legitimacy of governments have played an important role in Islamic history. For example, rulings in favour of British rule in India helped legitimize it, and rulings against the British supported the War of Independence in 1857. Many British policies in the Middle East were formulated in response to their fear that a ruling by the Ottoman Empire saying that Islamic law requires Muslims to act against the British could lead to widespread revolt in their Muslim colonies; see Fromkin (1991).

Maududi (1960) discusses the basic principles of an Islamic state with a very concrete and practical focus on creating a political framework for use in Pakistan and other Islamic countries. Summarizing the views of one of the leading scholars of Islam, Usmani (1970) highlights three important issues:

- The demands of struggles for liberation, and Islam's emphasis on the rejection of secular thought, has led some Muslims to over-emphasize the role of politics in Islam. Just as economics is a means to achieve spirituality, Q22:41 (cited above) states that political control is a means to establish worship and encourage good deeds.
- Democracy emerged in Europe in response to historical experience of the evils of autocracy - personal rule with unconstrained and arbitrary power. Europeans, and some Muslim followers, have generalized from the European experience to assume that the forms of government that have evolved in contemporary Europe (and even more recently North America) are the best models for all countries. Islamic governments have personal rule, but with many checks and balances against the abuse of power. In particular, a ruler is equal to his subjects before Islamic law. Rule (or leadership) is regarded as a responsibility not a privilege. A ruler must be chosen on merit, be of exceptional character, and may be removed for incompetence.
- Since political control is a means to an end, only Islamically permissible means may be used to achieve it. Currently, many of the methods being used by Muslims for political struggle are not permissible in Islam. Some Muslims have argued, incorrectly, that such methods are permissible because they are required for success. Several historical examples of how Muslims have sacrificed political success in the interest of religious goals can be identified. For example, Mu'awiyah ibn Abī Sufyān, the fifth Caliph of Islam, recalled his armies from a surprise attack (which had a very high likelihood of success) upon learning that such a tactic was not permissible Islamically in the particular situation he faced, immediately after expiry of a peace treaty.

5.1.2 The Ummah

Generally, government has come to be associated with the nation state. However, of relevance to the theme of this paper is the idea, stressed in Islam, that Muslims form one community or *Ummah*. This conflicts with modern concepts of the nation-state, which formulate governing arrangements on the basis of geographical partition. The as yet unresolved tension between the concept of the *Ummah* and the concept of nation has played out in many different ways in Muslim political arenas (see, for example, Piscatori, 1986). One example is Mustafa Kemal Ataturk's explicit choice of the modern identity of a Turkish nation and his aggressive promotion of it in preference to the more general Islamic identity of the Ottoman Empire. Although there have been attempts amongst Muslim countries to promote closer political, social and economic ties with each other in line with the concept of *Ummah*, events such as the separation of East and West Pakistan and the modest success of other initiatives is an indication of the current weakness of such international religio-political ties. Yousri (2004) discusses attempts at

economic integration among Muslim countries and their relation to Islamic law and the *Ummah*.

5.1.3 Decision-making processes

Arguably, the fundamental political problem is group decision-making in the absence of consensus and in the presence of conflicting interests. The main process of decision-making in an Islamic society is *shoora* or consultation. This was the practice of the Prophet Mohammad (s.a.w.) and is explicitly mandated in the Quran, which describes believers as being

(Q42:38) Those who hearken to their Lord, and establish regular Prayer; who (conduct) their affairs by mutual Consultation; who spend out of what We bestow on them for Sustenance.

Usmani and Shafi (1976) and Ali (1997) contain detailed discussions of *shoora*, derived from original sources and Islamic historical references. In *shoora* all members are encouraged to think about what is best for the group as a whole, in preference to the interests of individuals or subgroups. This creates a participatory form of government that differs in important ways from democracy, which often caters to the interests of the largest subgroup and tends to generate conflicts. *Shoora*, like other Islamic institutions and practices, is intended to create consensus and harmony within an Islamic community³⁵.

5.1.4 Citizens' rights and responsibilities

An Islamic government must provide to its citizens justice, security, freedom, and equity in all spheres:

Q16:90 Allah commands justice, the doing of good, and generosity to fellow men, and He forbids all shameful deeds, and injustice and rebellion:

In return, citizens are expected to obey the state authorities, except in cases where its orders are contrary to Islamic law.

Q4:59 O ye who believe! Obey Allah, and obey the Messenger, and those charged with authority among you. If ye differ in anything among yourselves, refer it to Allah and His Messenger, if ye do believe in Allah and the Last Day: That is best, and most suitable for final determination.

The preferred mechanism for the selection of a ruler is more like an electoral college (termed *ahl-ul-hall-wal-aqd*) than direct election. Members of the electoral college must satisfy certain conditions, but need not be bound to vote in any particular way. This same

³⁵ Traditional conceptions of the state, according to some, are based on a natural community with a common ethos and shared goals. Modern conceptions of the state, in contrast, are based on a 'social contract,' agreement to a set of rules for resolving conflicting interests. Manicas (1989) writes in this context that "the only thing which people have in common is 'the government' and, paradoxically, their *private interests!*" and describes the history of the transition from the traditional *polis* to the modern *societas* form of political organisation in Europe. Islamic principles of government are based on the traditional form, but make explicit allowance for minorities which may not share the same goals as the main community, permitting them far more liberty to self-regulate (through personal law) than is allowed in many states.

body may also be given the power to remove a ruler for incompetence or other (serious) reasons. Detailed discussion with reference to source materials is given by Ali (1997). Conditions in which revolt or rebellion are considered justifiable (under oppressive rulers) have received extensive discussion by Islamic jurists as well as more practically oriented politicians of the twentieth century. The principles of Islamic government require guarantees of freedom of religion and belief, freedom of worship, freedom of movement, freedom of expression, equality of opportunity, and the right to benefit from public services. Maududi's *The Islamic Law and Constitution* (1960) contains an extensive discussion.

Historically, Islamic civilizations have displayed much greater tolerance and provided much greater freedom to minorities than has ever been achieved in the West. In particular, the concept of allowing minorities personal law that is separate from the overall law of the state arguably achieves a level of freedom for subcultures that is greater than in many other countries. Menocal (2002) and Lowney (2005) describe Medieval Muslim Spain, and Akyol (2004, 2006) the Ottoman Empire, while Toynbee (1951) wrote: "The extinction of race consciousness as between Muslims is one of the outstanding moral achievements of Islam. In the contemporary world there is, as it happens, a crying need for the propagation of this Islamic virtue ... of tolerance and peace". In the *Human Development Report: Cultural Liberty in Today's Diverse World* by Sakiko Fukuda-Parr (2004), the provision of cultural liberties (of the type provided historically in Islamic civilizations) is presented as one of the pressing needs of the world.

5.2 Public finance

Since an Islamic state came into existence in the lifetime of the Prophet (s.a.w.), objectives of public expenditure that are legitimate according to Islamic law and legitimate means of raising revenue have been the subject of discussion among Muslim scholars from the earliest times. Indeed, this is what is traditionally meant by Islamic economics. This discussion, which delineates legitimate activities for a Muslim state, and also imposes constraints on the generation of revenues and use of financial resources, is at the heart of any conceptualisation of a modern Muslim state. Aghnides (1961) and Siddiqi (1948) provide a comprehensive discussion of the theories and some history of early administrative structures. A brief survey of modern authors is given in Ziauddin (1992). Several articles in *Readings in Public Finance in Islam* edited by Gulaid and Abdullah (1995) provide more complete discussions of the issues discussed briefly below. *Financing Public Expenditure: An Islamic Perspective* by Munawar Iqbal and Tariqullah Khan (2004) provides another survey of the area, with a very practical focus on the problems currently facing Islamic countries.

5.2.1 Revenues

Justification for any method of raising revenue for the state must be found in Islamic source materials, which include the methods used in the period of the Khilafat-e-Rashida. Of these traditional methods, four retain the greatest contemporary relevance. The first is *zakat* and *ushr*, which are dues on the wealthy meant primarily for the alleviation of poverty, and ranging between 2.5 per cent and 20 per cent for different categories of property. The rates and the potential uses of this revenue are directly specified in Islamic law, so that a state cannot appropriate this money for other uses. Because of its potential importance in poverty reduction, it is discussed in more detail below. The second method is a land tax (*khara*), which is quite flexible and may be used by a state for many

possible purposes. The third method is revenue from taxing or renting natural resources, or from management of other forms of public trust properties. The fourth is customs duties imposed on imports, in retaliation for similar charges being imposed on Muslim traders. Most traditional Islamic scholars hold that the government may impose no taxes other than those that are sanctioned by the tradition³⁶.

"Taxation policy in an Islamic economy" by Kahf (1995b) provides an able exposition of the traditional view, with reference to source materials. Since ownership of private property is a right of the individual granted by Islamic law, forcibly alienating this property by taxation is not permissible except where explicitly sanctioned by Islamic law. Thus arbitrary taxes for arbitrary purposes cannot be imposed by a government. Many modern scholars are in favour of giving governments a large number of duties in order to achieve development objectives, stabilize business cycles, provide social services, redistribute income, etc. In conformity with this broad conception of government responsibilities, they also favour giving broader powers of taxation to governments to allow for financing of these larger projects. *The Islamic Welfare State and its Role in the Economy* by Chapra (1995) provides a clear exposition of this view. Traditional scholars object to giving such a wide range of responsibilities to governments, not finding any sanction for them in the traditions of Islam. A *via media* is proposed by Ziauddin (1992), who suggests that if a society chooses (by consultation) to allocate a particular responsibility to the government, then it would acquire the required religious sanction to legitimise taxation for this specific purpose. Iqbal (1995), Sait and Lim (2006), Kahf (2000) and others have noted that traditionally, welfare activities by the public have adequately provided for food, health, education and other needs, so that in the past Islamic states did not have to provide for these needs. As discussed elsewhere, this reliance on individual responsibility for welfare and social service provision seems most in conformity with the Islamic tradition, in which the object of government is not the provision of social services as such, but the creation of a cooperative spirit, compassion and harmony. These can only be achieved by encouraging the public to take responsibility for provision of services in their communities.

Zakat is one of the five pillars of Islam, as well as a pillar of public finance for an Islamic state. It is an annual payment ranging from 2.5 per cent to 20 per cent of the value of specified types of property owned by the wealthy, with the primary object of alleviating poverty. It is a clear illustration of the use of wealth to pursue spiritual goals, since it is explicitly intended to create sympathy with and compassion for the poor amongst the wealthy. Despite its resemblance in form, some Islamic scholars object to the word 'tax' for the payment of zakat, since its payment is regarded as a form of worship. Historically, Islamic governments have collected zakat from the rich and distributed it to the needy. Because of its religious nature, it is easy to collect, except when the public does not trust the government to deliver it to the designated recipients. When governments do not collect and distribute it, Muslims are individually responsible for finding the needy and distributing the zakat to them. They are encouraged to prioritize first their next-of-kin, then the local community, and then the population more generally. Where institutions are weak and levels of trust low, most zakat funds are distributed individually by Muslims, based on personal searches for where the funds are most needed.

Because of its fundamental importance in Islam, zakat has been the subject of extensive research. Islahi (2004) has prepared a bibliography listing over 250 references on all

³⁶ The resemblance between these traditional methods for generation of revenue in an Islamic state, and the tax proposals of Henry George (1879) in his classic, controversial, and now almost forgotten *Progress and Poverty*, is quite striking.

aspects of *zakat*, from administrative to spiritual, including case studies of Islamic countries. Patterns of giving by the Pakistani community in the USA are documented in Najam (2007), and substantial additional research along these lines is under way. Literature reviews and assessment of the potential of *zakat* for poverty relief are given by Ahmed (2004) and Shirazi (2006). Disregard of attention to local detail and the one size fits all approach to poverty reduction of the IMF and World Bank, which has been critiqued by Stiglitz in numerous articles and books³⁷, is well illustrated by the case of *zakat*. Despite its centrality in Islam, its specific designation as a poverty alleviation measure and its appeal to Muslims, *zakat* is not, to my knowledge, mentioned in poverty reduction programmes designed by the World Bank for Muslim countries. A large amount of work on how to revitalise this key Islamic institution, adapt it to modern conditions, and make it more effective as a means of poverty elimination, is referenced in Islahi (2004).

5.2.2 Responsibilities and expenditure

The responsibilities and functions of the Islamic state define categories of state expenditure that are legitimate according to Islamic law. In addition to public administration, the state is expected to provide justice to all (citizens and others worldwide), ensure security (including law enforcement and defence), look after citizens' physical welfare by taking care of their needs, and provide for an equitable distribution of wealth and economic opportunities. The state is also required to look after the spiritual welfare of citizens by playing an active role in promoting the good and prohibiting the evil, as mandated in the Quran (Q22:41, cited earlier).

In the *Economic Role of the State in Islam*, Kahf (1991) describes these functions and their implications for the economic role of the state. One subtle and important issue that he brings up is the following: while asceticism, simplicity and other-worldliness are considered desirable personal goals, they are not to be imposed on others – the state and individuals are not permitted to duck their economic responsibilities towards others in the name of promoting simple lifestyles or asceticism. The debate over the functions and responsibilities of the state, summarized in Ziauddin (1992), has some parallels to, but also some striking differences from the analogous debate between conservatives and liberals in the west. First, it is a collective responsibility (*farz-e-kifayah*) of a Muslim society to take care of the basic needs of all its members (including health, education, and provision of opportunities for employment). *Farz-e-kifayah* is a special type of religious duty or obligation which does not, to the best of my knowledge, have an equivalent or analogue in Christianity or in secular law. If the duty is being fulfilled (in this case, the basic needs of all the members of the group are being met), then all are absolved of this responsibility. If the duty is not being fulfilled, then all members of the society are individually responsible to take care of whatever part they can. Responsibility is proportional to capability – those more capable of fulfilling the duty are more accountable. Since typically the state has a lot more capability than individuals, any gaps in the fulfilment of basic needs are the responsibility of the state. To the extent that private initiatives fail to meet this responsibility, the state is required to step in to fill the gap. At the same time, when a state fails to fulfil this obligation, the responsibility falls to individual citizens. A state can also be sued in an Islamic court to provide the required services. Each of the major responsibilities of the state and its implications for economic affairs is discussed separately below.

³⁷ See <http://www.globalpolicy.org/socecon/bwi-wto/critics/stiglitzindex.htm>

5.3 Justice

Islamic scholars agree that the provision of justice on all fronts is one of the main functions of an Islamic state. Economic affairs are to be managed so as to provide social and economic justice to citizens. There is a large literature on how the broad concept of justice translates into specific socioeconomic and political goals; see for example *Islam and Justice*, edited by Aidit Ghazali (1993). Kusha (1989) considers the political dimensions in *Social Justice: From the Islamic World-System to the European World-Economy, a Study of Power Legitimation*. In the economic realm, it is quite clear from Islamic source materials that economic justice does not mean equality of wealth and/or income. Rather, it implies the provision of education, training, employment and equal access to economic opportunities, as well as justice. This is discussed in greater detail in section 5.4 below.

The standards of justice required of human beings by Islam are extremely high. Muslims are required to bear witness, even if it is against their own self-interest:

Q4:135 O ye who believe! stand out firmly for justice, as witnesses to Allah, even as against yourselves, or your parents, or your kin, and whether it be (against) rich or poor: for Allah can best protect both. Follow not the lusts (of your hearts), lest ye swerve, and if ye distort (justice) or decline to do justice, verily Allah is well-acquainted with all that ye do.

It is worth noting that such a requirement was considered too much to ask by the framers of the USA constitution, and the Fifth Amendment allows people to abstain from bearing witness against themselves. Similarly, Muslims are required to be just, even against an enemy:

Q5:8 O ye who believe! stand out firmly for Allah, as witnesses to fair dealing, and let not the hatred of others to you make you swerve to wrong and depart from justice. Be just: that is next to piety: and fear Allah. For Allah is well-acquainted with all that ye do.

The Nuremberg trials show how difficult it is to match this standard: while German war crimes were punished, similar acts by the Allies were ignored³⁸. Justice is regarded as a minimal requirement – Muslims are encouraged to forgive and be generous. Thus when the Prophet marched victoriously into Mecca, he did not take revenge on the enemies who had persecuted him and his companions with great vigour and over a long period of time. He set standards of behaviour for Muslim armies, many of which have replicated this behaviour. For example, when Salahuddin Ayubi reconquered Jerusalem in 1187, he took no revenge on the Crusaders for their earlier massacres of the populace; instead he housed and fed them, and provided them with ships to take them back to their countries of origin. See also Feldman (2003) for testimony on the generally superior behaviour of Muslim conquering armies.

We note that the idea of ‘competition’ versus ‘cooperation’, one of the core differences between the capitalist and Islamic economic systems, is reflected even in the domain of justice. The explicit command that Muslims must, if necessary, testify even against our own best interests, and be just even to enemies, shows that we are all supposed to cooperate to arrive at a just outcome, disregarding our personal interests. In contrast, in the US legal system, justice is an incidental by-product of a mediated struggle between opposing interests. An excellent discussion of the ethical issues is given by a panel of

³⁸ For example, the fire-bombing of Dresden and the British blockade of food to Germany, which led to the death by starvation of an estimated 800,000 civilians, were ignored, while much lesser crimes by Germans were prosecuted (Glover, 2001, p. 66).

lawyers in “A case of competing loyalties” in *Stanford Magazine* (Fall 1983, p38-43). All on the panel agreed that a lawyer defending a male client known to him or her to be guilty of rape nonetheless is obliged to destroy the reputation of the female victim if this is the best possible defence. All agreed that the American criminal defence system is an adversarial process with artificial boundaries, rather than a pure search for truth.

Historically, Islamic states were equipped with a range of institutions that could be coordinated and harmonized to deliver justice in a way that is, even now, unparalleled. Naz (1999) has discussed these institutions and their sphere of operations, providing some history and additional references. Islamic scholars are agreed on the idea that ‘justice delayed is justice denied’, and there is great emphasis on speedy resolution of cases. The list of institutions given below should give the reader an idea of the framework for provision of justice in an Islamic state.

- The *Khalifa*, or Governor, was often a last court of appeal. Through much Islamic history, people were given easy access and special times to take their cases to the *Khalifa*, in accordance with early Islamic traditions.
- The *Mufti* or interpreter of Islamic law. While this was a purely scholarly position, with no immediate executive powers, Masud (1995) has shown how the *faqih*s, or scholars of Islamic law, wielded great power and enjoyed tremendous respect in early Islamic societies.
- The *Kadi* or judge decided cases. The Islamic system is not adversarial in nature, and several examples show that there is an emphasis on achieving a solution that is viewed as just by all parties. There are no lawyers, although the judge may consult specialists in Islamic law and call witnesses or other interested parties as necessary to arrive at a just outcome. There was an emphasis on speedy resolution of trials.
- The institution of *hisbah* dealt with violations of justice in situations where there was no particular aggrieved party or conflict of interests which would lead to a court case. In general, *hisbah* protected social interests. For example, pollution or other cases which are dealt with under class action law in some countries would, in Islamic states, have been handled by *hisbah*. Since *hisbah* also dealt with regulation of markets and consumer protection, it is closely related to the economic realm and is therefore treated separately in Section 6.4.
- *Diwan-ul-Mazalim*, or the Court of Abuse, dealt with cases of the abuse of power. Here complaints against powerful officials could be brought by ordinary citizens. Because of difficulties in prosecuting such cases under normal procedures, this court was often given powers outside the normal juridical ones, and could proceed in the absence of standard types of required evidence.

This recapitulation of traditional Islamic institutions does not stem from a desire to glorify or romanticize the past. It is clear that solutions to modern problems will require creative thinking and adaptation. Western political, social and economic institutions represent a solution to these problems which is strongly conditioned by a worldview and a history substantially different from that of Muslim countries. Contrary to what is widely believed, Western institutions are not universally applicable, and in particular, are not suited to the Islamic ethos. This makes it necessary to study history to find patterns of solutions consonant with Islamic traditions that can serve as a basis for new types of Islamic institutions.

5.4 Economic security and welfare

As discussed earlier, a Muslim society must collectively take care of the basic needs of all its members, including health, education, food, housing and provision of opportunities for employment. In *Guarantee of a Minimum Standard of Living in an Islamic State*, Siddiqi (1995) gives a comprehensive survey and further references relevant to most of the matters discussed in this section. It is important to note that the first responsibility of an individual is to fulfil his or her own basic needs; only those who are handicapped or temporarily unable to tend to their own needs are entitled to be assisted by others. There are a large number of Islamic laws which relate to provision of economic security for the disadvantaged. A comprehensive account is given in *Economic Security in Islam* by Qardawi (1981).

As discussed by Zarqa (1995, Section 4.3 (e)) and Siddiqi (1995, Section 2), recognition of this responsibility goes back to the earliest times of Islam. The second Khalifa of Islam, Umar said to a non-Muslim citizen who had paid taxes when young that he was entitled to be provided for in old age. The first state-run hospitals and orphanages, as well as pensions for widows, the handicapped and older people, were established in his time. Khalifa Umar bin Abd al Aziz is reported to have wept with the worry that he was responsible for and would have to answer to God about "the hungry, the poor, the unattended sick, the prisoner in alien lands, the very old, those with many dependents but little money, and similar people." Syed Abul Hassan Ali Nadi (1986) writes that the idea of collective responsibility for the needs of the entire world is one of the gifts of Islam to the civilizations of the world.

Maududi (1960, p. 331) reports that a group of eminent Islamic scholars agreed to the following item as essential for the constitution of an Islamic state: "It shall be the responsibility of the Government to guarantee the basic necessities of life, i.e., food clothing, housing, medical relief and education to all citizens without distinction of race or religion, who might be temporarily or permanently incapable of earning their livelihood due to unemployment, sickness or other reasons." Provision of economic security will protect life, create goodwill and harmony in society, provide equality of opportunity, and rectify many injustices. Economic security will also free individuals to turn to higher spiritual and social pursuits. Hasanuzzaman (1980), Chapra (1993) and Taseen (1998) discuss these goals. Note that these motives for the provision of economic security are radically different from standard secular ones, which are based on utilitarian or Rawlsian principles. In "The Islamic state and the welfare state: similarities and differences", Kahf (1995a) discusses the concept of the welfare state as it arose in the West and distinguishes it from the superficially similar Islamic conception.

Siddiqi (1995) gives a careful discussion of basic needs, citing sources and precedents, and also indicating how these needs may be related to social norms, climate and other factors. The mechanism by which Islamic societies are to look after these needs has also been spelled out. In the first instance, as noted above, every individual is responsible for looking after himself and his family. If a person is unable to do so, then it is expected that his or her kinfolk will take responsibility. If this does not suffice, then neighbours and people in the near community have the responsibility. All members of a society who have more than enough for their needs are exhorted to look after the less fortunate. Muslims throughout the ages have responded to this call by setting aside large amounts of property and wealth in trusts for social welfare projects (*waqf*; plural *awqaf*, discussed in Section 6.3). If an individual slips through these social security nets, it is then, as discussed above, the responsibility of government to provide for the unmet needs. Interestingly, this includes paying off the debts of the indigent, which is a religious obligation. Thus the government is the insurer of debts for all citizens.

The issue of sufficiency has also been discussed by Siddiqi (1995). If resources are inadequate to meet all the needs, then the community must prioritize according to guidelines prescribed by the *Shari'ah*. As a last resort, a community may pool its resources and share them equally. It is narrated that Umar R.A. said

If I had no money left to feed the people, and the only way left was to make all households share their provisions with an equal number, with everyone being only half fed till Allah gave us rain, I would have done so. For men could still survive on only half the food they need.

In Islamic history, there are a number of reported cases of this last resort solution, which shows how community needs are prioritised over individual needs. While a detailed discussion of this issue is deferred to Section 7, we parenthetically note that it is an explicit Islamic injunction to provide for the poor in an honourable way. In contrast, early poorhouses in England were designed to be shameful and degrading, so as to give people little incentive to stay; such an approach is prohibited in Islam.

Among the basic needs, education deserves special attention. It is the route to equal opportunity. It also plays a special role because it is an excellent channel through which the collective responsibility of the state and citizens to provide for people's moral development can be fulfilled. Islamic teachings place extremely high importance on education. The first lines of the Quran revealed to the Prophet state "*Read, in the name of thy Lord*". "Learning is from the cradle to the grave", according to the Prophet. The angels were told to prostrate themselves before Adam after he displayed knowledge that they did not possess. Writing about the culture of learning which arose in early Islam, as evidenced by libraries, a variety of educational institutions, and many schools of thought of Islamic law, etc., Kazmi (2005) states that, for an early Muslim "to be a Muslim and not be interested in learning would [have been] a contradiction in terms." Because education was considered a religious duty, and Muslims are not permitted to charge money for performance of religious duties, in Islamic civilizations, education was generally available to the rich and poor, as well as women and minorities. This provided for equal opportunities for all in a way that has rarely been matched. Shalaby (1954) gives a history of educational methods, syllabi, institutions, libraries, the inclusion of women, and other evidence of the prevalence of education in the first 600 years of Islamic civilization. Makdisi (1990) details the rise of institutions of higher education in Islamic civilization, and Goody (2007) documents both their imitation in Europe, and the suppression of this information in historical accounts. Dalrymple (2006, p 95) writes about the early period of British India that "He [the Muslim man] who holds an office worth twenty rupees a month commonly gives his sons an education equal to that of a prime minister. ... After seven years of study, the young Muhammadan ... [is nearly the equal of] ... a young man raw from Oxford." In *Education in Pakistan*, Qureshi (1975, p13-20) details how British colonial educational reforms and restrictions on access to jobs led to a public education system based on low-standard rote learning, which continues to impact adversely on educational standards in Pakistan.

5.5 Other functions of an Islamic state

In this sub-section, some of the functions that have been proposed for Islamic states, but about which there is more controversy, are discussed. A first area of controversy, related to the welfare standards discussed above, is the issue of the level of support for which the state is responsible. Kahl (1995a) argues that the state is responsible only for the bare minimum necessary: adequate and comfortable levels of support may only be

provided if sufficient public funds are available. Since provision of support above the bare minimum is not considered a responsibility of the state, it may not levy taxes to provide such support. Other authors have argued for a broader concept of state responsibility, and therefore also favour more extensive tax policy. Ziauddin (1992) summarizes the different points of view and discusses the related issue of exactly how to differentiate between basic/essential needs and less essential ones. Some authors have argued that this is not an important debate, since historically the state has not needed to provide for meeting basic needs. Instead, the historical pattern in Islamic societies was the free provision of education and health by private sector organisations (*awqaf*) – see M. Iqbal (1995) and Sait and Lim (2006).

While it is clear that Islam places a collective responsibility on a society for the fulfilment of the basic needs of all its members, it is equally clear that the religion does not ask for equalization of incomes or wealth. The Quran states that:

Q 43:32 Is it they who would portion out the Mercy of thy Lord? It is We Who portion out between them their livelihood in the life of this world: and We raise some of them above others in ranks, so that some may command work from others. But the Mercy of thy Lord is better than the (wealth) which they amass.

Thus God Himself has created inequality of incomes for a purpose. Measures of income inequality such as the Gini coefficient are, therefore, not of interest as measures of conformity between income distribution and Islamic ideals. However, a different matter, the circulation of wealth, is directly commanded by God:

Q59:7 What Allah has bestowed on His Messenger (and taken away) from the people of the townships,- belongs to Allah,- to His Messenger and to kindred and orphans, the needy and the wayfarer; In order that it may not (merely) make a circuit between the wealthy among you. So take what the Messenger assigns to you, and deny yourselves that which he withholds from you. And fear Allah, for Allah is strict in Punishment.

What emerges from this is that the wealthy are encouraged to spend, so that their wealth may circulate freely in a society. Note how this is exactly the opposite of primogeniture, with its concern for keeping wealth and lands concentrated. A number of moral concerns are addressed by this approach: the rich are encouraged to be generous, to be grateful to God for his favours (rather than proud of their acquisitive skills), and to promote the welfare of society by actively seeking out socially useful causes. Measures to promote circulation of wealth within a society include *zakat*, *sadaqat* and inheritance laws (see, for example, Mufti Shafi, 1978; Taseen, 1993; Siddiqi, 1980; Zarqa, 1995 and Anjum, 1995).

I conclude by noting an important tension created by the responsibility of a state to realize the spiritual by material means, as made explicit in verse Q22:41 cited at the beginning of this section. "Enjoining the right" means motivating people to do good deeds. A state which efficiently takes care of all the needs of the public can be counterproductive in that it may relieve people of their responsibility and promote indifference to others. Thus the primary objective of public policy is the creation of cooperation, sympathy and generosity, rather than the elimination of poverty. To this end, the best course of action is to encourage citizens to take on those responsibilities that they can shoulder, and for governments to step into the gaps as the last resort. However, states also have direct responsibilities towards their citizens. There is a fine line to be drawn between the two sets of responsibilities, and Muslim authors can be found on both sides.

6 The role of Islamic institutions

Q2:177 True piety does not consist in turning your faces towards the east or the west - but truly pious is he who believes in God, and the Last Day; and the angels, and revelation, and the prophets; and spends his substance - however much he himself may cherish - it - upon his near of kin, and the orphans, and the needy, and the wayfarer, and the beggars, and for the freeing of human beings from bondage; and is constant in prayer, and renders the purifying dues; and [truly pious are] they who keep their promises whenever they promise, and are patient in misfortune and hardship and in time of peril: it is they that have proved themselves true, and it is they, they who are conscious of God.

There are certain uniquely Islamic institutions, based directly on Islamic law and/or well-established historical Islamic practices, which have a strong influence on economic structures within an Islamic society or state. Many of these institutions became defunct or marginalized in a long and complex historical process of decay. The 'modern' expectation that all societies will travel along the same path, so that the Islamic heritage is only of historical value, has proven to be unfounded. An active search to rediscover the spirit of Islamic institutions and revive them is going on in the Islamic world (the Quranic verse cited above shows that the spirit is of the essence while the form can vary). There is also the challenge of adapting them to contemporary requirements, or creating new institutions which conform to Islamic laws while meeting modern needs. It is the tension between Islamic ideals and goals and the existing unsatisfactory mélanges of colonial/modern /Islamic structures which gives impetus to Islamic movements all over the world. Below we treat Islamic financial institutions, insurance, *waqf* (trusts or endowments), *hisbah* or market regulation and environmental protection in separate sections.

6.1 Islamic financial institutions

Given the clear textual prohibition of interest in Islam and the centrality of interest-based transactions in modern capitalist economies, the first practical challenge in implementing an Islamic economic system is the development of alternatives to interest. There is a huge amount of literature on this topic; a recent survey has been undertaken by Siddiqi (2004b). There are three routes to a resolution, as we discuss below.

Route 1: The simplest way out of the problem is to argue that modern banking interest is not the form of interest that is prohibited in the Quran. This route, the equivalent to that chosen by Christians and Jews, has not been accepted by the vast majority of Muslims, even though several attempts have been made in this direction - see Usmani (1999) for a rebuttal of all the main arguments. Among many reasons for this divergent outcome, it appears to be significant that Muslims continue to believe that the Quran is the revealed word of God, and that the traditions encapsulated in the *Hadeeth* are fundamentally sound. Jones (1989) shows that a re-interpretation of restrictions on usury as being metaphorical rather than literal was a key step in legitimizing interest in the Christian world.

Route 2: The second route is to find equivalents of existing modern institutions which serve the same functions and are compatible with Islamic law. This has been the most popular route, for reasons to be discussed. Ayub (2002) and Zaher and Hassan (2001) provide extensive discussion of the issue of how to create Islamic banks that can function without interest. Another useful and comprehensive reference is *The Encyclopedia of Islamic Banking and Insurance* (IIBI, 1992). Tariqullah Khan and Munawar Iqbal (2005) refer to the design of financial instruments that fulfil the functions of Western institutions while being *Shari'ah* compliant as 'financial engineering'. There are striking parallels between this route and the ones adopted by Christians *en route* to the abandonment of the prohibition of usury and its associated moral stigma - see Norman Jones (1989) *God and the Moneylenders: Usury and Law in Early Modern England*.

Route 3: A third set of authors (for example, Ansari, 2000 and Taseen, 2001), believe that Islamic institutions are radically different from existing capitalist structures, and that it will require a revolution to put such structures in place. In fact, most Muslims agree that Muslim institutions differ radically from their non-Muslim counterparts, but differ on the appropriate strategy for how to get from here to there. The second route (discussed in the previous paragraph) is a way of making evolutionary changes and modifications to existing western financial institutions and practices, to get rid of the most egregious violations of Islamic laws and begin to develop an economic system that resembles an Islamic system. Proponents of the revolutionary approach (e.g. Hafiz and Mahbub-al-Hassan, 2006) believe that such methods cannot work and that settling for less than an ideal approach will frustrate the revolutionary intent of Islamic methods. The basic ideas of the third approach and its application to insurance in an Islamic framework are spelled out most clearly in the introduction to the third chapter of Ghazi (1992) *Report on the Islamic Insurance System*. Instead of replicating or modifying capitalist institutions, he asserts, one must think through the purpose being served by an institution. If this purpose is in conformity with Islam, then an institution to achieve it in conformity with Islamic law must be developed. Historical evidence (see Mirakhor, 2007 for references) suggests that suitable modifications of traditional Islamic institutions can accomplish the desired objectives quite efficiently, in ways quite different from their Western analogues. Modern capitalist financial systems have evolved over centuries and today form a system of mutually supportive institutions, with both private and public sector involvement. A major difficulty faced by Muslim reformers, pointed out by many authors, is that a financial system is an integrated and coherent structure and piecemeal changes towards an Islamic system are quite difficult to devise, manage and implement. Replacement of an existing system by an Islamic system based on trust, community and no interest is a difficult job, requiring changes and interventions on several different fronts simultaneously.

There is a large amount of literature (and many controversies) regarding proposals for central banks, private banks, money creation and management, stock exchanges, handling government finances and loans, creation of steady income streams without interest-based instruments, mortgages and other consumer loans, etc. Innovative alternatives to existing capitalist instruments have been proposed and implemented. The most recent example is that of *sukuk* (a lease and buy-back alternative to bonds), which went from being a theoretical proposal to one of the largest sources of Islamic finance over a very short period of time. Instead of surveying the relevant literature, which is voluminous, complex and covers diverse domains of financial affairs³⁹, we follow the third route outlined above and discuss the main principles of a comprehensive Islamic solution

³⁹ Akram Khan (1983, 1991, 1998) has provided comprehensive annotated bibliographies.

to financial problems and how they differ from the current capitalist one. First, the underlying basis for a financial system is discussed, then a way of providing a secure home for people's deposits, and third how those deposits might be used.

6.1.1 The basis for financial institutions

To see how financial institutions in an Islamic economy would be structured, we must focus on the idea that money is a means to an end, which is at the heart of an Islamic economy. This contrasts with the idea of the 'endless accumulation of capital', which is at the heart of capitalism, and in which the primary purpose of money is to make more money (e.g. Weber, 1930). Since in Islam the purpose of money is to purchase the home of the hereafter (Q28:77), the emphasis is on using money for social projects of value. In a society based on cooperation and trust, individuals can get by with much less in the way of saving and personal wealth, since they can rely on others for assistance when their 'rainy day' occurs. Many Islamic rules are designed to produce such cooperation; for example, strangers are entitled to hospitality as a right. Travellers through the Muslim world have often recorded their experience of such hospitality; see *One Thousand Roads to Mecca: Ten Centuries of Travelers Writing about the Muslim Pilgrimage* by Wolfe (1998). For example, Malcolm X. (1965) found in his travel experience "a spirit of unity and brotherhood that my experiences in America had led me to believe never could exist between the white and non-white..."

A common objection to the idea of basing a financial system on cooperation and trust is that this is only possible in small communities, where personal relationships can be sustained. In large populations with transactions spread widely geographically, it is asserted that only modern anonymous and contract-based institutions can function. However, there is substantial evidence that contradicts this view. For example, Lopez (1976) shows that in the age of 'commercial revolution' (950-1350AD) trade flowed freely across the then known world, supported by risk sharing methods of finance, which had been developed in Muslim countries consistent with the *Shari'ah*. Mirakhor (2007) notes that these methods do require more trust than interest-based contractual ones, and suggests that shocks to the system caused by the crusades, Mongol invasions and the bubonic plague, led to the evaporation of trust and the subsequent emergence of interest-based transactions as the dominant mode of business. For our purposes, we note that history attests to the possibility of developing a global economy based on Islamic mechanisms of trust and cooperation, although the ways in which these might be designed and implemented in the contemporary global economy pose many difficulties.

6.1.2 Deposits

To accomplish some of the purposes discussed above, we need to revive and modernize the historical institution of *amanah*. In earlier times, people entrusted other trustworthy people with deposits. We need an institution, say *Dar-ul-Amanah*, which would fulfil the function of keeping deposits safely. This is one of the main functions of modern banks, which are, however, oriented towards profit making. Our *Dar-ul-Amanah* would have an entirely different orientation. A primary function has to be to preserve the value of the deposits of depositors. This involves some creativity in modern times, since paper money is not equivalent to the gold of old. One idea would be to allow the depositor a range of possibilities through which some index of the value of deposits could be preserved. For example, deposits could be stored in a bundle of currencies optimized for stability, or in the form of a local indexed basket of consumer goods, or could be more specifically

targeted towards particular future needs, such as the education of children. The main argument offered in favour of bank interest by Muslims has been the propensity of inflation to reduce the real value of deposits. An institution of the type proposed could overcome this problem without resorting to interest.

6.1.3 The use of deposits for socially profitable projects

A second important function of modern banks is that they pool surplus money and use it for investments. These are intended to increase the value of the deposits for the benefit of both the institution and (generally to a lesser extent) depositors; on the whole the means by which funds are invested is regarded as the banks' private concern. This system tends to lead to increasing concentration of wealth. Our *Dar-ul-Amanah* could instead invest in human and social capital, addressing social concerns and leading to the Islamically mandated circulation of wealth. An important job of the institution would be to search out the best opportunities for social welfare (on behalf of its depositors) and invest in such opportunities. For a start, if *zakat* can be levied by the institution on the wealth deposited in it, this amount would be available to it for use for charitable purposes. In addition, substantial amounts would be available for use as *qarz-e-hasana* (an interest-free loan made for charitable purposes), just as conventional banks can get along with a small fraction of reserves/liquidity. Such use would, of course, need to be with the consent of the depositors; however, there are numerous parallels and precedents for such practices in Islamic history. As noted above, not only do all Muslims have a responsibility to help the poor and work for welfare of society, but also they are encouraged to compete with each other in seeking out the best opportunities to do so. The *Dar-ul-Amanah* would seek out the best investments in the hereafter (the best social causes to support), exactly as modern banks seek out the most profitable investment opportunities in this world. One important investment could be to provide human beings with the skills needed to earn a livelihood; this type of investment is likely to have a long-run high return.

Muslims have debated the idea that Islamic banks have social responsibilities, and some criticize this as idealistic, romantic and impractical. In fact, large foundations and charitable organizations performing functions of this kind already exist all over the world, although they are peripheral as financial institutions. The Islamic ethos requires a re-orientation that would make these motivations and practices central and modern banking practices peripheral. The importance of human beings and social capital in the development process has been well established. The fact that human skills are the principal component of the wealth of nations (see World Bank, 2006) suggests that institutions of the type proposed above could promote economic growth more efficiently than conventional development strategies. Moreover, historical evidence suggests that this type of activity did occur extensively in Islamic societies in the past, at both personal and institutional levels (via *waqf*). The potential for using Islamic motivation to create new types of institutions that conform with the Islamic spirit is illustrated by the vastly successful Tabung Haji in Malaysia, which assists Muslims to perform Hajj and mobilises savings for this purpose; see IRTI (1995) for more details.

6.1.4 Investment and business finance

The main purpose of Western financial institutions is to use money to make more money for investors/depositors. As stressed above, Islamic financial institutions, in contrast,

must conform to Islamic law in form (in the process of accumulation, investment, and expenditure of money) and spirit (in promoting desirable social goals, fellowship, harmony and cooperation). The principles of self-interest and competition that underlie Western financial systems are inimical to the development of cooperation and community harmony; see Nelson (1969) *The Idea of Usury: From Universal Brotherhood to Universal Otherhood* for a historical study of the European experience. In particular, to further develop the discussion of interest started above, two additional arguments that demonstrate how the use of interest conflicts with Islamic principles are given below.

First, investment activities must be based on some form of partnership, of which many variants and forms are possible. This partnership is not merely financial; partners are expected to share in the fortunes of the business. Thus, it is not the enforcement of the legal contract by Shylock that troubles Muslims; it is his lack of compassion for Antonio in his time of trouble. Interest-based contracts are repugnant to the Islamic spirit because the lender gets repaid regardless of the business outcomes, taking his 'pound of flesh' out of the collateral if need be. In modern times, foreclosures of mortgages create the same kind of outcome, in which big businesses take advantage of farmers and homeowners in financial distress. Interest-based transactions promote indifference to the fate of others and are harmful to development of cooperation and community feeling.

Second, in order to be *halal*, earnings must be based on productive activity or real services rendered. Ownership of financial assets beyond one's needs is not a productive activity. However, entrepreneurship, which involves judgment, the selection of good business opportunities, and taking the risks entailed upon such selection, is a productive activity. Thus equity-based transactions built around real products and services are permissible in Islam, while purely financial transactions are not⁴⁰. This Islamic spirit is in direct conflict with the spirit of modern banking, where bank involvement in real transactions is often forbidden by law – the bank can only act as a pure financial intermediary. While conventional banks cannot be adapted to Islamic purposes, some types of western institution are compatible with Islamic law and therefore may be used as models for an Islamic economy. For large investors, some techniques currently in use in investment banks and by venture capital would work and could be borrowed. Because the risk is shared by the investor, these are largely in compliance with Islamic law. For small to medium investors, mutual funds would provide a suitable source of funds for investment. A large number of technical issues arise in adapting current Western financial instruments to the requirements of Islamic law; see Usmani (2000) for an accessible summary.

6.2 *Takaful* (insurance)

According to Atiquzzafar Khan (2005), Muslims first became aware of the practice of insurance as a result of trade contacts between Europe and the Ottoman Empire. We

⁴⁰ We illustrate the difference by the example of *murabaha*. A business purchases goods on credit, planning to repay after the goods are sold at a profit. The bank extends credit (using the goods as security) and requires a fixed repayment. The bank's transaction is purely financial – it gives the loan to the business and gets back the principal plus interest at a later date. The Islamic alternative is for the bank to buy the goods and resell them to the business at a profit, with deferred payment due upon sale. In appearance this transaction is quite similar, but it means that the bank bears some extra risks associated with the real part of the transaction, which would not be present in a purely financial transaction. There is a corresponding reduction in the risk to the business. If banks are large and businesses small, such a re-allocation of risks may actually promote economic efficiency.

speculate that cooperative practices in both personal and business life substantially reduce the need for insurance – a society is expected to take care of those in need. This may be why insurance was not needed and introduced in the original Islamic Empire, despite the existence of an extensive global trade network. When questioned about the permissibility of insurance, scholars of Islamic law have generally given negative answers. For example, Atiquzzafar Khan (2005) gives a history of rulings on insurance made by collective bodies of Islamic scholars in the twentieth century. While they recognized the utility of the practice, they found that it conflicts with Islamic law on several grounds.

First, an insurance contract contains *gharar* (uncertainty about the product received, or the price paid): in the case of damage, there can be a large payoff, while if there is none, such a payoff does not occur. Arguments that the statistical law of averages eliminates or reduces the uncertainty have been considered and rejected by Islamic scholars. In addition, an insurance contract resembles gambling, which is prohibited – in effect the insured and insurer bet on the occurrence of a random event. Also, in the event of a payoff being necessary, the insured receives more money than paid as a premium. This is regarded as a form of interest, which is prohibited. Finally, there is the issue of 'earned' wages – the question of what (real) service is provided by the insurance company⁴¹ for which it is receiving payment. What damage is caused by the insurance company for which it should bear liability in the case of loss? Neither the premium payment nor the recompense in case of loss seems justifiable in terms acceptable in Islamic law. While there has been substantial discussion back and forth on all of these questions, the consensus opinion is as reported above: the bulk of existing insurance contracts prevalent in the West are in conflict with Islamic law. For example, this was the decision of the Assembly of Islamic Jurisprudence held in Mecca on 10 Sha'baan 1398 (16th July 1978), with one dissenter.

Given the nearly unanimous verdict on the conflict between existing forms of insurance and Islamic law, the question is what alternatives might be possible. Ghazi (1992) considers some. He rejects the approach of modifying existing institutions to conform to Islamic law, and suggests that we should give new names to Islamic alternatives so as to clarify the radical differences between Islamic and capitalist forms of insurance; this has been widely accepted, so that Islamic forms of insurance are now called *takaful*. Ghazi considers the purpose of various different types of insurance contract, assesses the conformity between their purpose and Islamic law, and suggests different methods to achieve the same purpose that are within the domain of Islamic law. In general, the purposes of insurance (which include economic security, protection against possible losses and provision for heirs) are found to be compatible with the *Shari'ah*. However, achievement of these purposes within an Islamic framework requires different approaches for different purposes. We discuss some of the cases in broad outline, to give a flavour of the Islamic approach. For details, The *Encyclopedia of Islamic Banking and Insurance* (IIBI, 1992) is available. Also, the annotated bibliographies of Akram Khan (1983, 1991, 1998) provide an entry into the rapidly expanding literature.

For life insurance and pension plans, government-sponsored plans are generally acceptable, since governments are responsible for taking care of their citizens. For most of the other purposes, private sector insurance schemes are more appropriate. However, the general principles on which they are based are different from conventional insurance contracts. According to Ghazi (1992):

⁴¹ If the insurance company actually transports goods, and provides guarantee of safe delivery, this may provide Islamically valid justification for an insurance payment upon loss.

The foundation of assurance can be based only on cooperation, mutual sympathy, brotherhood, and mutual guarantee. Hence no system can be adopted whose real and basic aim is business, profit-making, and money hoarding.

See Atiquzzafar Khan (2005) for more references to similar views by other scholars. Islamic law permits only mutual insurance, where a group collectively safeguards the interests of its members and acts to support them in the case of damage. The elements of *gharar*, gambling, interest and unjustifiable payments, discussed earlier, are avoided if the intent is to help each other and there is no profit motive involved in the insurance contract. Note that the emphasis is both on the creation of community feeling and the intention behind the contract. Some of the problems with western forms of insurance, which create conflict of interests between the parties, are known as 'moral hazard' and 'adverse selection' in the technical literature. Thus in the case of private medical insurance, patients may have little incentive to reduce costs, doctors can and do select expensive alternative for treatment and order more medical tests, and insurance companies have reduced incentives for cost savings since they can pass on costs to customers. As a result, in the USA, costs per patient with private insurance are twice those in comparable countries where universal health care is implemented, like the UK, France, Canada, Germany and Japan; see the report of the Lewin Group (2005), which documents the inefficiencies of private medical insurance. Results from experimental economics show that problems of conflicts between social and private interests can be reduced or minimized when cooperation is encouraged and selfish behaviour that disregards group interests is discouraged. This suggests that Islamic insurance systems, which are designed to promote cooperative social behaviour, should lead to more efficient economic outcomes.

Another important feature of Islamic insurance is prevention of the concentration of wealth; Ghazi (1992) states that "Islam forbids concentration/hoarding of wealth. Hence, no system of insurance may be adopted as a result of which a few persons grow rich". The reason for this concern is that conventional forms of insurance require the insurer to be very wealthy; this was noted as early as Adam Smith. Given the ubiquity of insurance, this provides opportunities for making profit and increasing wealth that can only be utilized by the wealthy, leading to further concentration of wealth. Mutual forms of insurance avoid this problem by utilising collective responsibility and sharing the burden of insurance.

A number of different models for providing Insurance within the framework of Islamic law have been devised and implemented in practice by *takaful* companies that have recently come into existence. One model is based on the idea of a *waqf* that provides help to its members. Another model uses gifts (*tabarru*), and a number of mixtures and alternatives have been proposed. The idea of this piece of financial engineering is to use historically acceptable forms of Islamic contracts in order to devise a combination that parallels existing insurance schemes. Some authors have made more radical proposals based on historical Islamic institutions; the main idea is one of widening circles of responsibility. In times of trouble, as noted above, the family is the first source of support. If this proves inadequate, then the extended family is expected to shoulder the responsibility. Even larger difficulties are the collective responsibility of the entire tribe/community. Creative adaptation of these institutions may provide an alternative to insurance. Instead of family and tribe, it might, for example, be possible to form an association of bus owners within first a city and then a country. Generally speaking, the

individualistic bent of western institutions makes them incompatible with Islam, although in the case of insurance, there are some western models that have potential for adaptation within Islam. For example, the German health insurance system has some resemblance to the proposals discussed above. Individuals are placed into groups, and all groups receive compulsory coverage of a similar type. Also, Health Maintenance Organizations offer a model which could be adapted to Islamic models of mutual insurance. Here a group of people make monthly payments, which cover the cost of hiring the services of physicians and buildings, and all the required health needs of the group are met by these hires. This type of service contract is permissible within Islamic law (subject to certain limitations) and may be regarded as a form of an insurance contract.

6.3 Waqf (endowment/trust)

The *waqf* is a unique Islamic institution, which has played a tremendously important role in Islamic civil society in the past, though it is currently marginalized, for reasons discussed later. Under Islamic law, anyone may settle a property, its usufruct and incomes derived from it for specific projects of social welfare. *Awqaf* were set up and encouraged by the Prophet (s.a.w) as a form of 'eternal charity'. As already discussed⁴², those with resources to spare have a responsibility for seeking out those less fortunate than themselves, and giving them this excess (as a loan or as a gift) in a way that does not damage their self-respect. The idea of making a profit from the needs of the poor is repugnant to the spirit of Islam – it sacrifices an end for a means. In contrast, the irrational pursuit of wealth for its own sake, which according to Weber is the spirit of capitalism, has led some economists to give such primacy to making money that even helping the poor is seen as a means to the goal of making more money⁴³. Traditionally, wealthy Muslims have set up *awqaf*, which are highly encouraged and considered to be among the best ways of using surplus money. Since the asset (typically land) is not used up, revenues from it can theoretically be used forever for charitable purposes; this is regarded as one way of excelling in the competition for good deeds that is the purpose of life. There is a 45-page bibliography of English articles on many aspects of *awqaf* prepared by Islahi (2004), and other bibliographies in Arabic, referenced in Islahi, which are more extensive, since there is more material on this topic in Arabic. Comparable western institutions are charitable foundations and perhaps NGOs, with the difference that a *waqf* is subject to an extensive set of rules based on Islamic law.

Numerous authors (e.g. Kahf, 2000; Iqbal, 1995; Sait and Lim, 2006, Chapter 7) have discussed the significance of *waqf* in Islamic history, and all have concluded that they formed a substantial and significant portion of the economy and played an important role in all dimensions of civil society. It is estimated that about one third of the land in the Ottoman Empire was devoted to such trusts. According to Hoexter et al (2002, p. 128):

The *waqf*'s contribution to the shaping of the urban space can hardly be overestimated... A major part of the public environment in (Islamic) towns actually came into being as a result of endowments.

⁴² Q2:219 ...*They ask thee how much they are to spend; Say: "What is beyond your needs."*

⁴³ For example, a leading economics textbook (Samuelson and Nordhaus, 1985) mentions poverty only tangentially, and states that economists should study how to help the poor without harming production efficiency. In the Reagan era in the USA, tax cuts for the rich were justified on the grounds that they would invest and create more wealth, while the poor would only consume the tax cuts. Theories of "human capital" view humans as inputs to production of wealth, rather than wealth as an input to human welfare. Nobel Laureate Milton Friedman (2005) argues that it is the responsibility of firms to pursue wealth, not social goals.

While there were a tremendous variety of charitable purposes for which millions of *awqaf* were used throughout Islamic lands, the five main categories were food, housing, health, education and religion. Kahf (2000) gives some historical details on the relative size of these various sectors and further references. Sait and Lim (2006) indicate that the Ottomans did not see themselves as responsible for social welfare, suggesting that the *awqaf* took adequate care of these needs of the population. Thus these institutions formed an historic Islamic alternative to the current European welfare state model for providing for people's needs. The Islamic methodology has two distinct advantages:

- The *awqaf* were locally based and managed. They had substantially more local information than state-run systems typically do, and could therefore perform more efficiently.
- The Islamic requirement that social institutions should inculcate a sense of responsibility, reinforce social ties and increase social awareness was also fulfilled by this system⁴⁴.

Sait and Lim (2006) write that the system of *awqaf* "succeeded for centuries in Islamic lands in redistributing wealth", leading to equitable outcomes and the circulation of wealth in accordance with Quranic injunctions. In addition, by providing independent incomes to numerous small persons and institutions, the *awqaf* empowered civil society against the state. Historically, states attempted to curb this power and regulate the *awqaf* in various ways, but such efforts were successfully resisted. Women endowed or managed a significant number of *awqaf* and had a correspondingly significant impact on civil society; Faizer (2007) provides a useful bibliography. Equal access to education via *awqaf* and the general respect for learning in Islamic societies led to representation of all social classes within their intellectual elites: Kahf (2000) cites Al-Syed (pp 237-258) as stating that "at times, the majority of Muslim scholars [came from] the poor and slave segments of society, and very often they strongly opposed the policies of the rulers".

Waqf has a strong legal basis, and there is a huge literature on different types of *waqf* and rules concerning their operation, the permissibility of utilizing different types of property for *waqf* and debates among the different schools of Islamic law on major and minor aspects of *awqaf*. Once set up, a *waqf* cannot easily be shut down. Furthermore, the original purpose of the creator of the *waqf* cannot easily be changed. Because of these Islamic rules, some have argued that an important cause of Islamic decline was that many *awqaf* were locked into uses that became dysfunctional over time (e.g. Kuran, 2004). In fact, there is substantial dynamism and flexibility in Islamic law, and creative adaptations to changing situations can be documented in different areas, as we have discussed in different contexts in the current paper. Rather, it is clear that Islamic society as a whole became ossified and did not adapt to changing situations in many different dimensions. Hodgson (1974) gives a large scale view of the Muslim decline that avoids most of the elementary errors committed by Orientalist analyses. It appears likely that the

⁴⁴ The gradual abdication of social responsibilities to the state has led to major problems for welfare systems. The state cannot efficiently assess local needs and provide for them. Moreover, taxes to finance needs are often viewed as unjust and unfair, since they are often not targeted to the social needs perceived as the most urgent by those being taxed. In this context, it is interesting to note that an attempt was made by the Reagan administration in the USA to put the responsibility for old age parental care back on children. However, changes in social norms are hard to reverse.

increasing dysfunctionality⁴⁵ of the *awqaf* was an effect of the general decline of Muslims rather than a cause. The bibliography by Islahi (2004) lists a large number of articles dealing with the issue of how to update and modernise the *awqaf*.

Because of their firm basis in Islamic law, *awqaf* were able to resist efforts by many Muslim rulers to curb their influence. However colonising powers were not constrained by Islamic law. Seizure of *waqf* properties occurred on a large scale not only because of their wealth, but also because their organisational and material resources often permitted the *awqaf* to act as focal points of resistance to colonisation.

In the post-colonial era, for complex reasons, several Muslim countries have abolished, nationalised or created stringent regulations for *awqaf*. Sait and Lim (2005, Paper 7) write that

The eclipse of the endowment (*waqf*) has left a vacuum in the arena of public services, which the State has been unable to fill easily in many Muslim countries. However, both the 'idea' of the endowment (*waqf*) and the endowment (*waqf*) doctrine itself remain influential and there are clear signs of its reinvigoration. The endowment (*waqf*) served and continues to serve as an instrument of public policy and impacts on all aspects of Muslim life.

There is today widespread agreement among Muslims on the need to revive the institution of *waqf* and give it the central importance that it had in the past. Discussions of how to add flexibility to the laws of *awqaf*, revive the institution and adapt it to modern conditions abound in the Islamic economic literature. Numerous conferences discussing all aspects of the issues involved have been held. Sait and Lim (2005, Paper 7; 2006) discuss some of the required reforms, noting that Kuwait has taken a lead in this area. Kahf (1998b) and Zarqa (1994) also discuss how to revitalise this important Islamic institution and identify suitable old and new modes of financing.

6.4 Hisbah (audit or accountability)

In "Markets and prices", Kahf (1996a) provides an elementary introduction to various types of market failure that require regulation by the state. He also discusses the spirit of Islamic economic institutions, which is to find a cooperative solution to such problems, while minimizing infringements on the free operation of markets. Indeed, Islam puts a great deal of emphasis on individual freedom in all spheres of action (including the marketplace), and regulates it only when social interest so requires. Kahf (*op. cit.*) notes that the semi-judicial institution of *al-hisbah*, operational from the earliest days of Islam, is "charged with responsibility of carrying out the spirit of the system, setting conditions that preserve and enhance the public health and interests, protect the consumers, solve business and labor disputes, promote good market behavior, and ensure their observance."

Naz (1999) gives a comprehensive survey of *hisbah*, including its basis in Islamic law, its theoretical and historical functions within Islamic states, and its similarities with and differences from other judicial and executive institutions within an Islamic framework. Regulation of markets is among the main functions of *hisbah*, and because of our focus on economics, we are mainly concerned with this aspect. However, Naz (1999) mentions

⁴⁵ No evidence is offered for whether or not this "increasing dysfunctionality" actually took place. An alternative view more in accordance with history is that dismantling of Islamic legal structures allowed opportunistic governments to seize assets of *Awqaf*, which led to breakdowns in their functionality.

that the translation ‘market supervisor,’ used by several western authors, is too narrow to cover all the functions of *hisbah*, which include all aspects of public morals. To illustrate, it was responsible for

- finding mates for orphans and widows (when they could not do so themselves),
- ensuring that teachers did not punish students too severely,
- enforcing Islamic public codes of conduct, including those mandated by social norms, and
- repairs of public property like wells, canals or city walls.

As a general rule, the *hisbah* protects the public interest in cases where there is no immediate aggrieved party that can take the case to court. In the realm of the marketplace, the *hisbah* ensured that weights and measures were of official standard; provided stamps of quality; ensured that goods being sold were of standard quality by various means; took action against false advertising, hoarding to increase prices, collusion and monopolistic actions; and generally protected the public interest. Issues like pollution of rivers or the environment also fall under the jurisdiction of the *hisbah*. An examination of these different roles and their implementation in different periods of Islamic history is given in Chapter 5 of Naz (1999). A subtle but important issue is that *hisbah* is concerned solely with the public domain: visible immorality. If people drink or gamble in private, the *hisbah* is not authorised to investigate and discover this. In fact, the Quran mandates that private actions should not be investigated (Q49:12).

To compare the *hisbah* with western institutions, we first note a well known deficiency of free market mechanisms: in situations where large benefits accrue to a small group, while a small amount of harm is distributed over a large group, free market mechanisms generally favour the small group and lead to outcomes harmful to the public interest. The concept of the class action suit has been devised to overcome this problem, and in recent years, substantial legislation and literature has addressed this issue. A study of the career of Ralph Nader clearly reveals the major issues raised by taking on large corporations in the public interest, and the non-existence of government support or protection for such causes, at least in America. *Beyond Nader: Consumer Protection and the Regulation of Advertising* by Pitofsky (1977) discusses the issues in the context of advertising, while New Zealand MCA (Ministry of Consumer Affairs) (2005) provides a broader review and literature survey. It is therefore of great interest to note that an official equivalent of Ralph Nader has existed as an Islamic government institution from the beginning of Islamic states.

In general, the laissez-faire orientation of economic theorists and the presumption that market outcomes are generally best has led to substantial delays in recognition of market failures that cause harm to consumers and failure to develop appropriate methods of redress. An extreme position is taken by Friedman (2005), who argues that “The only business of business is to make profits”, implying that socially harmful consequences can be disregarded in the pursuit of profit. Islam takes a clear view on this issue, assigns social responsibility to all agents including firms, and has mechanisms for monitoring and enforcing accountability in the form of the *hisbah* institution and associated administrative arrangements.

6.5 Environmental protection, ecology and natural resources.

Amongst the social consequences of irresponsible and unregulated business activities and the pursuit of luxurious lifestyles we can include the environmental problems that

have been created on a scale massive enough to threaten human and other life on this planet. For example, Robbins (2007) writes that about 5 hectares of productive land are required to maintain the lifestyle of an average person in a rich country, while only 1.7 hectares per person are available worldwide. The process of fulfilling demand for luxurious lifestyles leads to large scale destruction of planetary resources in a way that is clearly unjust for both our contemporaries and future generations. In reaction, the concept of 'sustainable development', which proposes to achieve economic growth in a manner that can be sustained in the long run, has been developed. This is superficially similar to Islamic views in terms of its intended results, but differs dramatically in intent, as discussed by Yousri (2005). Thus in some views of sustainable development, although certainly not all, economic growth is the objective, and protection of the environment is regarded as a means to ensure that growth can continue to take place in the future.

In the Islamic view, like that of many other faith traditions, natural resources are a sacred trust, and protecting them for future generations a primary responsibility (Birvndhavaradarajan, 1992; Foltz *et. al.*, 2003; Sidek, 1989). Economic growth is not (directly) a goal at all, though it may be desirable as a means to (say) poverty alleviation. Fahim Khan (2003) discusses the relevance of these issues to theories of consumer behaviour. While some aspects of environmental protection fall under *hisbah*, environmental issues more generally are the collective responsibility of society as a whole, and measures to ensure environmental protection, natural resource conservation and the maintenance of biodiversity can be taken by the state, specific institutions, or individuals.

The Quran talks about people who are fair in speech, but make mischief on earth and destroy crops and progeny (Q2:204-5). The Prophet s.a.w. established a green belt of twelve miles around Medina, and prohibited people from cutting trees or hunting in this area. He prohibited pollution of drinking water, and Muslim jurists have deduced, therefore, that it is not permissible to dump garbage and waste products into rivers. He also encouraged revival of barren land by assigning property rights to those who did so. On the basis of these traditions, Muslim jurists in the Middle Ages legislated against industrial activities that pollute the environment (see Iqbal, 2005).

It is clear that if an exhaustible natural resource is private property, then the owner generally has an incentive to exploit it fully in his or her lifetime, and no incentive to save it for future generations. Islam considers that all natural resources are held in trust and has banned private ownership of them. Instead, states are supposed to hold natural resources in trust for future generations and must ensure that all can benefit from them. Justice to those not born requires the conservation of natural resources and their utilization in a way that is fair to all. For example, the Prophet commanded us not to waste even a few drops of water, even if we are next to a river. Armies were instructed not to burn trees or destroy agricultural land. Destruction of the natural habitat of animals, and of flora or fauna, is not allowed. There is emphasis on planting of trees and flowers, and these are treated as acts of virtue. Hadeeth says that if you are in process of planting a tree and Judgement Day arrives, keep on planting. Justice applies not just to humans but also to animals, and humans are prohibited from torturing animals or hunting them purely for pleasure. Animals used for service must be treated fairly and not hurt or punished severely.

In addition, Muslims have been commanded not to emulate luxurious lifestyles (see Akram Khan, 1989, p18-20). Ironically, as a large amount of recent research shows (for example, Lane, 2001; Layard, 2005), extravagant consumption does not lead to

additional happiness, satisfaction with life, or a sense of wellbeing; pursuit of wealth turns out to be an illusion, as the Quran states (Q3:185).

Statistics detailing the current state of affairs in Muslim societies and resulting policy priorities are given in Kahf (2003). For a practical illustration of the Islamic approach in the context of Malaysia, see Choudhury and Salleh (1993). The farsightedness of the Islamic perspective is astonishing given the formulation of Islamic principles in an era of a far simpler economy.

7 The role of Muslim individuals

Q13:11 ... Verify, God does not change men's condition unless they change their inner selves ...

In many parts of the preceding discussion, it has been emphasized that Islamic institutions must be built around individuals who share a Muslim ethos and are united in the common purpose given by Islam. It is widely acknowledged that such individuals are currently scarce in Islamic societies. Some Muslims have taken the view that first we must change individuals, and then institutions and societies – the grassroots or bottom-up approach. Others advocate a top-down approach, suggesting that the persuasive and coercive powers of governments will provide a faster vehicle to achieve the desired social transformation. Islamic history and source materials provide support for both points of view. Reconciliation is possible when we realise that Islam asks Muslims to engage with the world as a means of achieving inner spiritual transformation. The struggle to create a just, cooperative and caring community, and the Islamic institutions which support such a society, will also bring about the changes in individuals that are required by Islam. Islamic teachings provide a series of principles on which Muslims are exhorted to base their lives. In this section, those relevant to the economic sphere are summarized. As clarified by our discussion of methodology earlier, descriptive accuracy is not relevant. Rather, these principles and norms provide goals towards which all Muslims are expected to strive, both individually and collectively, and which can also be used for the purpose of training children.

- **Productivity:** In general, Muslims should be productive and earn enough to cover their sustenance. Akram Khan (1989, p. 36, 3.3-4) cites sayings of the Prophet praising those who make an effort to earn a living for themselves and their dependents. Earning less than one needs necessarily makes one dependent on others. The act of begging or asking others is, however, very much disliked and discouraged in Islam. At the same time, neither is too much engagement with the world, in the form of earning more than necessary, recommended. The best form of sustenance is to earn just enough for one's needs. Needs are defined sufficiently broadly in Islam that one is not commanded to lead an austere and ascetic lifestyle: *Q7:32 "Say: Who has forbidden the beautiful (gifts) of God which He has produced for His servant and tayyibat (things clean and pure) (which He has provided) for sustenance?"* Good general discussions of consumer behaviour in Islamic theory are given in Kahf (1996b), Taseen (1998) and Fahim Khan (2003).
- **Spending on others:** In Islam, there is a tremendous emphasis on *infaq* or spending in the path of Allah. Kahf (undated) writes that "*infaq* means giving away for the betterment of society and its members (including the giver and his family)". More than 150 ayat of the Quran encourage spending, more than those devoted to the famous five pillars of Islam. One is "*Q3:92 By no means shall ye attain righteousness unless ye give (freely) of that which ye love.*" Among the countless traditions regarding *infaq*, Kahf (1996b) cites: "*The creatures are all dependent on Allah, and the most beloved by Him are those who are most beneficial to His dependents.*" Knowing the propensity for avarice, greed and love of hoarding within the hearts of men, spending is encouraged first on one's immediate family, second on neighbours, and then in a widening circle of responsibilities. Such spending can be compulsory or voluntary. As discussed above, compulsory categories include the *zakat* and some similar requirements. There is

also an obligation for community responsibility where, if needs are not met, then spending becomes obligatory for all. Finally there are voluntary categories, for which there is substantial encouragement. There are two types of voluntary spending. One is a one-shot act designed to take care of a particular need. The second is a long-term planned contribution to the welfare of the society, which usually takes the shape of a *waqf* (discussed above).

- **Equality:** Islam carries a very strong message of the equality of all human beings in front of God. Superiority comes only from closeness to God. The Prophet gave an example of a poor man who, because of his relationship to God, was much more important than a world full of rich men. Formal relationships like servant/master, teacher/student, king/people should not fill people with pride and make them think that they are superior or inferior. An important consequence is the Islamic emphasis on the dignity of the poor. This is to be contrasted with class-based attitudes that associate superiority and inferiority with social group or wealth. In Islam, several measures are taken to ensure that the poor are not treated disrespectfully in the process of charitable giving. The Quran commands Muslims not to spoil our charity by saying hurtful words – indeed, it is better not to give than to give abusively: *Q2:262 Those who spend their substance in the cause of Allah, and follow not up their gifts with reminders of their generosity or with injury, for them their reward is with their Lord: on them shall be no fear, nor shall they grieve.*" The rich are told that the poor have rights in their wealth. Further, they are obliged to seek out needy people. The poor are told not to ask for help; instead they are urged to conceal their needs. The Quran tells us that the needy will not reveal their needs, and that they may be recognised by certain signs: *Q2:273 (Charity is) for those in need, who, in Allah's cause are restricted (from travel), and cannot move about in the land, seeking (For trade or work): the ignorant man thinks, because of their modesty, that they are free from want. Thou shalt know them by their (Unfailing) mark: They beg not importunately from all the sundry. And whatever of good ye give, be assured Allah knoweth it well.* It is then up to the rich to find ways of giving that will not offend the dignity of the poor.
- **Moderation:** Islam commands Muslims to be moderate in spending (Q25:67) and not to pursue ostentatious and luxurious lifestyles. Some sayings of the Prophet recommending simplicity are given by Akram Khan (1989, p77, 7.1-7). At the same time, asceticism is not encouraged. A man who was dishevelled and in rags was told to display the wealth that Allah had given him by the Prophet; see Akram Khan (1989, p. 83, 7.11). Two types of spending are specifically forbidden: *israf*, which is to spend extravagantly, and *tabzeer*, which is to spend on that which is forbidden, like wine or gambling. Taking loans is also discouraged, except for worthwhile purposes. In particular, loans for stylish consumption (and thus the credit card-based consumer culture) are very much against the Islamic ethos and spirit. A detailed discussion with references to source materials is given in Taseen (1998, p. 141-158). As indicated in Section 6.5, moderating consumption is an essential element of any strategy of sustainable development; see also Fahim Khan (2003).
- **Prohibition of envy:** Islam prohibits Muslims from envying others and teaches strategies to prevent envy. The Prophet told us to look at people less fortunate than ourselves in worldly affairs, so that we feel thankful for what we have. The Quran states:

(Q4:32) Hence, do not covet the bounties which God has bestowed more abundantly on some of you than on others. Men shall have a benefit from what they earn, and women

shall have a benefit from what they earn. Ask, therefore, God [to give you] out of His bounty: behold, God has indeed full knowledge of everything.

Making others envy us, via conspicuous consumption, is also prohibited in Islam.. The rich should conceal their riches to prevent envy – the exact opposite of conspicuous consumption. At the same time, the poor are encouraged not to envy the rich, but to be content with their lot. True richness is that of a heart with a generous disposition. Taseen (1998, p. 153-156) cites the Quran and Hadeeth in support of these principles. From Veblen (1899) to Lane (2001) and Layard (2005), many have identified envy as an important source of waste and unhappiness in capitalist economies.

- **Compassion:** The development of feeling for others is stressed in Islam. The Quran writes about the Prophet that “heavily weighs upon him (the thought) that you might suffer, full of compassion and mercy towards the believers”. In other verses, the Prophet is described as being “Mercy for all mankind”. The Quran praises those who feed others while being themselves hungry: (Q59:9) “who love all that come to them in search of refuge, and who harbour in their hearts no grudge for whatever the others may have been given, but rather give them preference over themselves, even though poverty be their own lot.” The second caliph of Islam, Umar Farooq R.A., ate coarse bread, because he felt ashamed to eat refined bread when not all of the public could do so. It is the spread of sentiments like this that can solve the problems facing the world today.

8 Concluding remarks

Allah's Apostle said, "If Adam's son had a valley full of gold, he would like to have two valleys, for nothing fills his mouth except dust (of the grave)." -- Al-Bukhari: Vol. 8, Ch.76, No. 447:

The fundamental economic problem is a normative one: what should an individual (and a society) do with surplus wealth? Islamic teachings, in common with other faith traditions⁴⁶, ask us to purchase paradise by spending on others. There exists a substantial amount of data to show that, contrary to the pessimistic views of Malthus and his followers, there are sufficient resources to provide for the basic needs of everybody on the planet. However, modern western commitments to individual freedom lead to idle desires of the wealthy and corporate greed being placed on a par with the needs of the hungry and sick. There is general agreement with the Hadeeth cited above that wants are unlimited. Since all wants cannot be fulfilled with available resources, a political commitment to 'consumer sovereignty' leads to the view that the fundamental economic problem is that of 'scarcity': there is not enough fulfil all wants. The solution is then sought in increasing wealth and material resources to fulfil these wants. A clear-sighted view of the issues is presented by Keynes, one of the architects of modern economic institutions as well as economic thought. He thought that the pursuit of wealth for its own sake was "a disgusting morbidity," but considered it to be necessary at the time he was writing. It is worth quoting Keynes in full:

When the accumulation of wealth is no longer of high social importance, there will be great changes in the code of morals. We shall be able to rid ourselves of many of the pseudo-moral principles which have hag-ridden us for two hundred years, by which we have exalted some of the most distasteful of human qualities into the position of the highest virtues. We shall be able to afford to dare to assess the money-motive at its true value. The love of money as a possession — as distinguished from the love of money as a means to the enjoyments and realities of life — will be recognised for what it is, a somewhat disgusting morbidity, one of those semi-criminal, semi-pathological propensities which one hands over with a shudder to the specialists in mental disease ... But beware! The time for all this is not yet. For at least another hundred years we must pretend to ourselves and to everyone that fair is foul and foul is fair; for foul is useful and fair is not. Avarice and usury and precaution must be our gods for a little longer still. For only they can lead us out of the tunnel of economic necessity into daylight" — cited in Skidelsky (n.d.)

Unfortunately this Keynesian solution, currently being pursued with vigour all over the world in the form of policies for growth and development, is failing because wants increase with increases in wealth, as the Hadeeth cited above indicates. For example, Layard (2005) and Robbins (2007) document that substantial increases in wealth in western societies have not led to the desired consequences in terms of increases in happiness, satisfaction, contentment or a sense of wellbeing. Douthwaite (1992) has also evaluated growth on many dimensions and found it wanting. In the meantime, the disastrous consequences of pretending that 'fair is foul' have manifested themselves in all dimensions of human existence. The trillions of dollars being spent on killing and destruction testify that it is not material resources but the will to do good that is scarce.

⁴⁶ Some secular traditions also provide strong support for this idea of spending excess wealth on others in need. See Singer (1972) for a powerful argument based on utilitarian ethics, which has been very influential.

Environmental and ecological catastrophes resulting from the senseless pursuit of money for its own sake have been documented by many. The Quran states that

30:41 Corruption has appeared on land and sea because of (the evil) which men's hands have done, that He may make them taste a part of that which they have done, in order that they may return.

Current solutions to the economic problems arising out of encouraging greed, avarice and usury as a means of leading us out of the tunnel of economic necessity are not working. Islam provides an alternative by clearly distinguishing between needs and wants, and encouraging social responsibility for the needs of all while discouraging fulfilment of idle desires. This basis for solving the economic problems of humankind differs radically from any currently on the conventional economic menu (e.g. the World Bank website). Islam offers a vision of a society based on cooperation and community harmony, people who take care of each other in times of need, and an economic system to match. Historically, Islamic civilization has taken much better care of its disadvantaged and poor, as well as minorities (by offering them religious and cultural freedom), than others, including current European civilization. Is it not worth struggling to create such a world? That is what Islamic economics is about.

Within each human being, God has placed the potential to rise above the angels. He has shown each of us "*the two paths*" (Q90:10) – the high road as well as the low – and left us free to choose: (Q73:19) "*Let whosoever wills, choose the path to His Lord*". As Muslims, we engage in a struggle to make the world a better place for humans, as a means to find the way to our Lord. We are all given only one chance to live. I conclude with the prayer that God guides us to the straight path and fulfilment of the potential for excellence that He has placed within us all.

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