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# Treatment of Consumption in Islamic Economics: An Appraisal

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**ABSTRACT.** This paper attempts a broad appraisal of the literature on macro consumption function in Islamic economics. It starts with a brief look at the microelements of the concept and clears several cobwebs concerning wants and needs, scarcity of resources, the basket of goods, and the efficacy of utility and its maximization for consumer equilibrium. The explanations narrow down the conceptual gaps between the micro and macro level articulations of the subject.

Next, the paper reviews some selected macro models resting on division of income on the basis of *nisab* between the upper (rich) and the lower (poor) classes of society for analyzing the impact of *zakah*-moderation mechanism on economic growth via the saving-investment route. It is demonstrated that, contrary to the claim based on models, the positive impact of Islamic scheme on the variables studied is uncertain, to put it mildly.

Finally, attention is drawn to some recent developments in the treatment of consumption in economics as also to interest being shown in the subject in other social sciences. This inter-disciplinary approach seeks to detach consumption from income and links it to wealth. It also brings in environmental and ethical concerns into the picture. The effort promises to bring the treatment of consumption closer in the two economic disciplines, secular and Islamic: it is a welcome development.

## 1. Introduction

Islamic economics started as a formal academic discipline only after 1975<sup>(1)</sup>, and has now completed over twenty-five years of its development and expansion. Perhaps it is time to take stock of the progress the subject has made over the years in various fields, and identify the challenges it may face in a fast changing, rather tumultuous, world<sup>(2)</sup>. It is with this perception that the present paper takes a close look at the treatment of consumption in the literature on Islamic economics.

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(1) The First International Conference on Islamic Economics took place in Makkah in 1976. Some major recommendations of this Conference concerning the setting up of educational and research institutions were put into operation in the following years.

(2) The New World Order that is now being evolved under the Western dictates, especially the US, is using the scepter of secularism to threaten the role of religious moral and ethical values in the organization of economic activity.

Writers treating consumption with an Islamic perspective have essentially shown interest in investigating the determinants of consumer behavior on the demand side of price formation in microeconomic settings, though they did attempt some macro formulations as well to explain the processes of determination of income or its distribution. In any event, the two are linked as microanalyses provide the necessary foundation for dealing with the phenomenon at the macro level. There is, therefore, advantage, rather propriety, in reviewing both sorts of discussion together.

Economics as currently taught in Islamic institutions is mostly anchored in the mainstream tradition with reference to curricula frames, course structures, reading materials, and the researches made. The phenomenon is likely to continue far into the future for a variety of reasons. Indeed, there is now realization that greater attention has to be paid to 'teaching of economics in Islamic perspective' than to the 'teaching of Islamic economics'<sup>(3)</sup>. The available Islamic analyses, therefore, hardly move out of the orthodox mainstream groove in approach, method or content. But not a few writings in the area, including consumption, take a rather puritan approach, assuming as if an Islamic social order is already in place. They derive their inspiration from past and often lose sight of the great irreversible changes that have been taking place in social ethos over the centuries. This is not to deny the validity or value of such writings. The point is they appear to be out of tune with ground realities, and their compulsions. The present appraisal tends to bypass points raised in the literature that do not or cannot reconcile with the temporal requirements of the community.

The paper is spread over five sections including the introduction. Section 2 evaluates the treatment of consumption at the micro level. This includes a look at what is usually presented in the literature under the title: theory of consumption, or as a preface in the macro models. Here the main issues discussed are the distinction between wants and needs, utility as guide of consumer behavior, and maximization of satisfaction. Section 3 looks at modifications of the consumption concept for income determination at the macro level. Attempt is made to show the impact of abolition of interest, introduction of *zakah*, and avoidance of *israf* i.e. excessive consumption on savings and investment in an Islamic economy. Section 4 deals with the relationship between consumption as desired by the Islamic ethics and social welfare: an upcoming subject that has scantily been touched upon by Muslim economists. Section 5 provides a summary of the review, and contains a few concluding remarks. The paper deals with the literature produced in the English language on a selective basis; it focuses on the issues rather than on author wise contributions.

## 2. Micro Foundations

What Islamic economics deals with under the 'theory of consumption' is largely the hierarchical setting of human wants, and what regulates consumer behavior in the process of their satisfaction, given a resource constraint. Islamic departures in consumer theory from the mainstream positions are broadly set up with reference to these two matters. The law of demand remains untouched.

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(3) The author has explained the compulsions leading to this situation in an earlier work. See **Hasan** (2002, pp. 97-98).

There is a natural urge in man to seek pleasure, and to escape or remove pain. The urge constitutes what we call a human want in mainstream economics. Wants being psychic are unlimited. Individually, most of them are satiable but are of a recurring sort. These characteristics of wants keep pressure on man for their satisfaction, and have in that been the primary spring of human toil and progress. These facts are well recognized in the religious, including Islamic, literature<sup>(4)</sup>. However, one does not come across any meaningful discussion on wants – their definition, characteristics, and nature – in Islamic economics. What usually is highlighted is their classification.

The relationship between unlimited wants and scarcity of resources that gives rise to the issues of choice making in human life is the foundation of economics, and gives the subject its nature and content under the secular dispensation. Islamic economists in general endorse this relationship but there *are* scholars who candidly declare that there is no place for the scarcity of resources notion in Islamic economics. It may be noted that the reasons they advance for the denial of scarcity are not tenable<sup>(5)</sup>. The proponents conveniently forget their own position on the point when they take up for discussion other economic issues, theoretical or applied. We need not digress here to elaborate on the concept of scarcity for Islamic economics. Suffice it to say that the history of the march of human civilization is the history of pushing outward relentlessly the frontiers of scarcity through unceasing inventions and innovations in science, technology, and social organization<sup>(6)</sup>.

We need goods and services to satisfy our wants as defined earlier. However, Islamic scholars tend to confuse *needs* with wants<sup>7</sup>. They equate the two, and classify needs into three categories, providing linkages between them<sup>(7)</sup>. To begin with, there are the *daruriyat* or necessities of life like food, clothing, shelter, education, health care and so on. What would improve the quality of the necessities is regarded as *hajiyyat* i.e. complements or improvements. Lastly, we have *tahsiniyat* or the needs whose satisfaction accords us social status or recognition. The latter two are seen as a sort of expansion of the necessities of life. The three are thus interlinked and picture a graded improvement in the quality of life. The focus of attention is on goods that satisfy needs falling in each category<sup>(8)</sup>. The needs remain the *same* but their satisfaction improves as we move higher up on the scale.

Missing in the above narration is an objective criterion for the classification of needs to facilitate analysis. What would be a necessity, complement, or improvement at a time

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(4) The Qura'nic injunctions saying "But waste not by excess for Allah loves not the wasters" (6: 141; 7:31) as also those condemning the hoarding of wealth (104:2-3) imply the scarcity of resources *available* to human beings for use at any time. "Truly, man is created in toil and struggle". (90:4)

(5) The Qur'an informs us that Allah has stocked the earth (and heavens) with his inexhaustible treasures to provide sustenance not to man alone but to all his creatures. Some Muslim scholars – for example, **Akram Khan** (1994, pp. 44-45) -- draw from it the inferences that the concept of scarcity is extrinsic to Islamic thought. The claim is naive, to put it mildly. One must realize that the *existence* of ample resources in space and time for the entire creation is the manifestation of Allah's benevolence, but the extent of their *availability* to mankind is, in His wisdom, a function of human knowledge and effort. It is in this latter sense that resources are scarce and constitute a basic element in giving rise to economic phenomena around us. Indeed, how resources can be increased is today what the world is worried about.

(6) For details see **Hasan** (1996, p.582). Compare Ahmad (2002, pp. 23-27)

(7) Jurists usually discuss this classification. See **Khan** for an interpretation (1995, Chapter 2)

(8) See the chart and discussion in **Khan** (1995, pp. 39-40), also **Siddiqi** (1992, p. 21), and **Chapra** (2000, p. 307).

and place for a consumer is largely internal to him. No observer, even a jurist, can impose his verdict concerning needs (or welfare) on him from outside<sup>(9)</sup>. Also, it is the wants that can be so classified, not the goods that satisfy them<sup>(10)</sup>. In contrast, the mainstream classification of wants -- necessities, comforts and luxuries -- rests on an objective measurable criterion<sup>(11)</sup>. Necessities are wants whose non-satisfaction would result in a reduction of work efficiency of a person, while addition of comforts is likely to improve it. Satisfaction of luxuries may have little impact on efficiency, may even reduce it, if the consumption is injurious to health. Here, the categories need not have a linkage or layering. Furthermore, the same commodity may fall in any of the categories depending on the nature of want for a particular individual. The point is that there is an external criterion for classification: the impact of consumption on work efficiency. It is difficult to see how this approach is opposed to Islamic norms, or cannot be adapted to the Shari'ah requirements. The adaptation would help avoid many pitfalls in constructing a micro theory of consumption for Islamic economics. It will eliminate the conceptual wedge one finds between the micro and macro level treatment of the variable<sup>(12)</sup>.

Now, what shapes the behavior of a consumer for attaining equilibrium in mainstream economics, and how do Islamic economists react to the process? Put briefly, the consumer is assumed to be a rational being in the sense that he seeks to maximize his satisfaction from a given income. Several approaches – utility calculus, indifference curve technique, and revealed preference theorem – have been used to explain the process of achieving the objective. They remain the same in their aim – maximization of consumer satisfaction -- the form alone changes. These approaches have weaknesses<sup>(13)</sup>, but they have served well the purpose of erecting the law of demand for mainstream economics. The law states that normally there is an inverse relationship between the price and quantity demanded of a commodity under the assumption that certain things – the income of the consumer and his *tastes*, the prices of related goods, and the market conditions of competition – remain unchanged.

Islamic economists raise a number of objections to the above formulation of the mainstream theory. To begin with, they are averse to a maximizing behavior on the part of any economic agent, let alone the consumer but some find it just alien to Islamic norms<sup>(14)</sup>. A blanket rejection seems untenable<sup>(15)</sup>. Maximization *per se* is value neutral. What is maximized, how, and to what effect are the questions to be answered before

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- (9) **Khan**, (1995 pp. 34-36, also 2002 pp.61-64) narrates in this connection what Shatibi described as five fundamentals for existence in this world i.e. defending life, property, faith, reason, and posterity. However, it is an exhortation more for collective action rather than an individual imperative. For individuals, it presumably falls in the Islamic category of *fard kifayah*. **Ahmad** (2002 pp. 51-53) sees *darurah* as the *necessity* rule of *Fiqh*. One must not confuse needs or wants with *maqasid al Shariah*.
- (10) A car could be a necessity for a busy surgeon or businessman, a comfort for a university professor and a luxury for a student.
- (11) Most of the elementary economics textbooks in India and elsewhere contained this classification and its basis during the middle of the twentieth century. One finds a cursory mention of necessities, comforts, and luxuries in **Siddiqi** (1992, p. 56) as well as in **Chapra** (2000, p.307).
- (12) Interestingly, Islamic economists conveniently ignore the microeconomic positions they so laboriously erect when they cross over to the macro side of the fence. There, they tend to grab on the same concepts of growth, consumption, savings, and investment as we have them in the mainstream economics except that interest is eliminated from and *zakah* is introduced into the models.
- (13) Microeconomics textbooks usually discuss these approaches and their weaknesses. Nevertheless, one may find their critical evaluation also in **Hasan** (2002, pp.109-111).
- (14) See **Siddiqi** (1996, pp. xiii, 17, and 56) for his total rejection of the proposition for *any* economics.
- (15) The author has argued in defense of the mainstream maximization hypothesis for Islamic economics. See **Hasan** (2002, pp. 95, 101, and 112). **Monzer Kahf** too strikes a positive stance (1992a, p. 65)

passing a final judgment in a particular case. For example, should an administration desist from maximizing tax revenue within the confines of law? Shall we decry a person who seeks to maximize the pleasure of Allah, however he may try it following the Shari'ah? Or shall a consumer be foolish if he enhances satisfaction as much as possible from a given income once he has fulfilled his religious obligations? One may find it difficult to answer such questions in the affirmative. Scarcity forces maximization on economic agents for an efficient use of resources and lends meaning to avoidance of their over or wasteful use, in consumption as well<sup>(16)</sup>.

Furthermore, Islamic economists often cite the following verses from the Qur'an or arguing that a believer is not to be miser or extravagant in spending his wealth: he is to follow the middle path:

“And let not your hand be tied (like a miser) to your neck, nor stretch it forth to its utmost reach (like a spendthrift), so that you may become blameworthy, and in severe poverty” (17:29).

“And those who when they spend, are neither extravagant nor niggardly but hold a medium (way) between those (extremes)” are the true believers (25:67).

Explaining the second of these verses, Monzer Kahf observes that the extravagance as limit becomes non-existent when one is “spending for charity, for the improvement of the community, and for the propagation of the message of Islam” (1992a, p. 65). The interpretation looks a bit stretchy if the two verses were taken together. In normal circumstances, expenditure even on the mentioned heads should not leave one in destitution<sup>(17)</sup>. Siddiqi too regards minimum consumption essential (1992, p.54). In any case, these verses, or others quoted on the point in the literature, refer to apportioning of one's wealth between spending on his own needs and in the way of Allah, not perhaps about how one must spend on permissible goods the amount he eventually decides to spend on self<sup>(18)</sup>. The latter has rarely been discussed in Islamic economics. Another murky notion that has permeated the Islamic theory is that the basket of goods in the case of a Muslim consumer would be smaller than that of a non-Muslim as the former will keep out the non-permissible (*haram*) goods<sup>(19)</sup>. Clearly, it is the money value of the basket not the sort of things it contains that determines the size of expenditure on it. A believer can spend much more on permitted goods alone than a non-Muslim would on a basket containing non-permitted goods as well<sup>(20)</sup>.

(16) **Siddiqi** (1992, p.2) supports the validity of the scarcity notion for Islamic economics but shuns one of its logical consequences: the maximizing effort on the part of economic agents. Islamic economists who endorse the idea usually qualify it, like Siddiqi, and talk of *relative* scarcity. This looks rather intriguing: relativity is inherent in the concept. One cannot talk of resource scarcity in economics without implying that wants/needs to be met are *relatively* larger.

(17) **Khan** (1995, pp. 47-48) has the same position as Kahf on the point. However, the conclusion does not follow from the verses cited. Verses 2:15 and 2: 19 also refute their position.

(18) Some believe that the instructions apply to both cases. It is, however, naive to construct a downward sloping trade off line as in **Khan** (1992, p. 71) or curves as in **Zarqa** (1992, p. 108). The marginal rate of substitution in either case is at once indeterminate and is known to Allah alone. Such formulations are in a way anti-faith: they measure Allah's reward without knowing it with the loss of worldly pleasures!

(19) Many scholars have mentioned the point, but **Khan** (1995, p. 51) highlights it in particular.

(20) See **Hasan** (1985, p.79, and 1990, Section 1 for comments on Iqbal who is in agreement with Khan on the point)

Finally, there are some misgivings about the role utility plays in the mainstream analysis of consumer behavior. Part of difficulty arises because of the already stated confusion between wants and needs and insistence on the hierarchy of needs. It is seldom realized that the hierarchy was a matter of temporal thought and expression not a belief imperative. One can reasonably demand evidence for the hierarchy being *eternal* for Islamic dispensation. Neither human wants nor goods that satisfy them can be ordered as suggested by anyone for individual consumers. Of course, public policy can rank societal needs and review the ranking periodically to address the *maqasid*<sup>(21)</sup>.

Characteristic of the position Islamic economists take on utility analysis of consumer behavior are the following observations of Siddiqi (1992, p. 21):

The assumption that the consumer maximizes utility or satisfaction implies that all goods and services have a common denominator called utility or satisfaction, which can be measured or at least compared with one another. This idea is not acceptable in view of the hierarchy of human needs and the fact that the same commodity may serve a number of needs. This makes a generalized analysis of consumer's equilibrium impossible<sup>(22)</sup>.

If money could be a common denominator for measuring the exchange value of goods and services as expressed in their prices, why utility cannot be a common denominator for measuring their value in use is not clear. One reason possibly is that utility is seen as intrinsic to commodities and is not distinguished from satisfaction. The fact is that the locus of utility is human mind; it does not reside *within* commodities. Thus, a glass of water may have no utility for one who is not thirsty. Also, the utility of identical units of a commodity for a consumer would not diminish as he has more of them. Again, utility is the satisfaction one expects from consuming a commodity; it is an *ex ante* concept. Expectations guide the consumer in allocating income to various uses, including savings. Satisfaction, on the other hand, is an *ex post* notion; how one feels after consuming a thing. Utility – expected satisfaction – need not equal realized satisfaction. Thus, we have at times pleasant surprise or disappointment after spending money on a commodity. The source of both may often be incomplete information in an uncertain world.

Presumably, one reason of aversion to using utility analysis, including indifference curves, and beyond is that the concept has its roots in utilitarian rationalism. This need not be a difficulty. We can use utility as an analytical tool, and discard its philosophical bearings. Still better, we can Islamize the mainstream notions of rationality and utilitarianism as Kahf (1992a, 1992b) so convincingly demonstrates.

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(21) Take, for example, the case of keeping wealth secure. The individual may spend on doors, grills, locks etc depending on costs *he* deems fit to incur for the purpose. The state would provide police protection and a system of dispensing justice; it will maintain a defense force to ward off external aggression within budgetary constraints set by the community. What would one regard the *need* for the individual as a *Shariah* imperative, and of what *category*?

(22) It is argued that the concept of utility involves value judgment, regards desires as the best criterion for the formation of preferences, and does not distinguish them from needs. In Islamic economics *maslahah* is a more objective concept for analyzing the behavior of economic agents. (Khan 1995, pp. 31 and 35). The author does not establish his claim. Rather, he negates it in the next breath admitting that *maslahah* is as subjective as utility in the sense that the individual consumer himself is the best judge of whether a particular good/service is *maslahah* for him (p. 35). This is *faux pas par excellence*.

To conclude, let us detach the notion of wants from needs, understand the real import of scarcity, utility, and satisfaction, see the benefit of retaining the maximization hypothesis for analytical purposes, and shed aversion to using the utility tool. This is not to plead their acceptance as in mainstream economics. They can be and are being successfully modified to meet Islamic norms and requirements. Their retention will reduce, if not entirely eliminate, the conceptual divergences in the meaning of the same terms while passing from micro to the macro part of economic analysis from Islamic perspective.

### 3. Consumption in Macroeconomic Frames

In this Section we shall mainly deal with two publications. First is the work of Khan that initially appeared in the *Journal of Research in Islamic Economics* (JRIE) in 1984. A subsequent issue of the Journal contained some valid comments on the paper (1985). The study was later reproduced unchanged as Chapter 3 in the *Essays in Islamic Economics* (1995). The second is the work of Iqbal - *Zakah, Moderation, and Aggregate Consumption in an Islamic Economy* - that too appeared in the same Journal (1985) followed by a comprehensive review later (Hasan, 1990). The two works have much in common. Both attempt to modify the elementary Keynesian structure for constructing an Islamic departure. Others, including Siddiqi and Chapra, also talked of aggregate consumption but their views are cursory and inconsequential.

Khan (1995) sought to demonstrate that consumption in an Islamic economy is likely to be lower and savings larger than if the same economy were operating on a non-Islamic basis. He finds no room for the apprehension expressed in certain quarters that transfer of income via *zakah* from the rich who have higher propensity to save to the poor with a high propensity to consume would reduce saving and investment in an Islamic economy thus impeding growth (pp. 45-46). His thesis relies on the presumption that the Islamic norms would keep the consumption basket of a Muslim smaller<sup>(23)</sup>, and *zakah* is likely to spur growth in the long run. Based on these premises Khan has systematically developed his argument and has designed a cogent set of illustrations for proving his point.

To begin with, he divides the income (Y) of the community into  $Y_U$  and  $Y_L$  respectively on the basis of *nisab*.  $Y_U$  is income above *nisab* i.e. of the rich or upper classes and  $Y_L$  the incomes below *nisab* i.e. of the poor or lower classes<sup>(24)</sup>. The division of total consumption (E) into for self ( $E_1$ ) and for the cause of Allah ( $E_2$ ) including obligatory *zakah*, corresponds to the income classification. Thus,  $E = E_1 + E_2$  where  $E_1 = Y_U - E_2$  and  $E_2 = F(a, Y_U)$ , 'a' being some function of T, the fear of Allah (pp. 54-55). Khan's micro consumption function rests on these formulations. Now,  $E_1$  and  $E_2$  being baskets of *real* goods cannot be added together. Also, total expenditure on them cannot be equated with money income unless we multiply each by its price as under (Tag-el-Din, 1984, p. 57).

$$\dot{Y} = (P_1 E_1 + P_2 E_2). \quad (1)$$

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(23) We have already shown above the erroneous nature of this presumption.

(24) *Nisab* is the ownership of minimum asset value that would attract the payment of obligatory *zakah*.



Ignoring the blemish, we may have a look at Khan's utility maximization process:

$$U = F(E_1, E_2) \quad (2)$$

His observation that the marginal utility of E is positive and goes on declining as its stock with the consumer increases (p. 54) is in the familiar groove. However, he has imposed a separation condition on the utility function for deriving an independent model for  $E_2$ . Tag-el-Din sets  $U = U_0$  and shows that  $dE_2 / da$  and  $d^2U_0 / dE_2$  are both negative<sup>25</sup>. So, the indifference curve showing equal-utility combinations of  $E_1$  and  $E_2$  would be downward sloping and would also be convex from below. He argues that given this framework a Muslim consumer can reduce his spending in the way of Allah i.e.  $E_2$  while increasing his own consumption  $E_1$  and that too at a rising rate to keep his expected satisfaction constant all along the curve. Thus seen, the basic utility model Khan took as a point of departure from the mainstream consumption function "does not represent the behavior of a genuine Muslim consumer"(Ibid, p. 61).

Tag-el-Din did raise some pertinent points, but they are more of a technical import. My own difficulty is not about how Khan has erected his structure, but concerns the validity of his claim that savings and investment are likely to be larger in an Islamic economy compared to a non-Islamic one. In his scheme three factors influence the division of a Muslim's income between  $E_1$  and  $E_2$  sort of uses: obligatory *zakah*  $Z$ , additional voluntary spending by way of charity  $Z_1$ , and the fear of Allah  $T$ . The first two operate exclusively on  $E_2$ . The third ( $T$ ) plays a dual role: first it tends to encourage  $E_2$  expenditures, and second it restrains the believers from *israf* or extravagant spending on self. To the extent  $T$  encourages increase in  $E_2$  spending it must reduce savings out of a given income  $\dot{Y}$ . In contrast, to the extent it helps shun *israf*, it must enhance the component of savings in  $E_1$ <sup>26</sup>. Thus,  $T$  exercises two contradictory effects on savings, given the income. To fix ideas, let  $\lambda$  be the fraction of  $Y_U$  the consumer assigns to spending in the way of Allah i.e.  $E_2 = \lambda Y_U$ , and  $\beta$  the fraction of  $E_1 = (Y_U - E_2)$  that is saved. Thus, if *israf* decreases  $\beta$  would rise. Now, it is easy to see that consumption would equal  $(1 - \lambda)(1 - \beta)\dot{Y}_U$  and savings  $(1 - \lambda)\beta\dot{Y}_U$ . We may recall that  $\lambda$  and  $\beta$  are both increasing functions of  $T$ . Let us consider the savings equation:

$$\begin{aligned} \text{Given } Y_U = \dot{Y}_U, \text{ this yields} & \quad S_U = (1 - \lambda)\beta Y_U \quad 0 < \lambda, \beta < 1 & (3) \\ \text{and} & \quad dS_U / d\lambda < 0 \\ & \quad dS_U / d\beta > 0 \end{aligned}$$

Evidently, the two functions of  $T$  pull  $S_U$  in the opposite directions and their net effect can hardly be predicted. This alone is sufficient to dismiss the thesis of Khan. But as the net result of  $T$  can also be positive we may continue with our appraisal of his work.

After explaining the micro foundations of his argument Khan moves to constructing his macro model. He starts with the mainstream Keynesian equation:

$$C = a_0 + a_1 Y \quad (4)$$

(25) See **Tag-el-Din** (1984, p. 60-61) for proofs. In contrast,  $dE_2 / da > 0$  in Khan (1995 p. 54)

(26) Khan defines the consumption of a believer ( $C^*U$ ) out of  $E_1$  as  $[1 / (1 - \beta)] CU = C^*U$ , where  $\beta$  is an increasing function of  $T$ . Thus,  $CU = (1 - \beta) F(E_1)$  P. 56.

Here, C includes the consumption expenditure of both the upper and lower classes i.e.  $(C_U + C_L)$ . It is assumed that  $Y_L$  is all spent on consumption. The *zakah* recipients are supposed to be so poor – at least in the short run - that even the transfer to them of  $E_2$  by the rich from their incomes may not enable them (the poor) to have any savings (p. 55). These assumptions *ipso facto* require a recasting of the Keynesian function, an imperative the author missed. The C intercept  $a_0$  would be larger, for it will now include  $E_2$  as well. Likewise,  $a_1$  would become the marginal propensity to consume of the upper class alone. One may write the constant as  $A_U$ <sup>27</sup>. Thus, the Islamic consumption function in the mainstream tradition can be written as follows:

$$C^* = A_0 + A_U Y_U \tag{5}$$

The manipulation gives rise to an interesting question: will  $A_U$  be greater or smaller than  $a_1$ ? Intuitively, it looks as if  $A_U$  would be larger. But the opposite can also be true if the aggregate consumption level remains the same as it was before introducing the Islamic change. Alternatively, if the two coefficients stay equal ( $a_1 = A_U$ ), consumption under Islamic dispensation would tend to rise at the cost of savings.

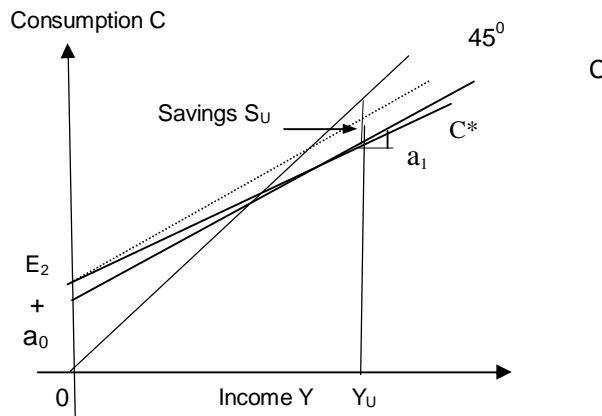


Fig1: Impact of E2 expenditure on consumption in an Islamic economy

Figure 1 provides the explanations. Here, C is the initial consumption function with  $a_0$  the intercept, and  $a_1$  the marginal propensity to consume of the rich upper classes. They save  $S_U$  out of the income  $Y_U$ . When income  $E_2$  is transferred via  $(Z + Z_1)$  to the poor lower classes, it may have one of the two consequences. As no saving is assumed out of  $E_2$ , C intercept must rise to  $(a_0 + E_2)$ . Now, if the consumption in the economy remains the same as before the marginal propensity of the rich to consume would fall appropriately to make up the consequent fall in  $S_U$ : notice the reduction in

(27) Khan does not modify in his work the  $a_0$  and  $a_1$  constants of the traditional consumption function even when he incorporates Islamic elements into it.

the slope of the new consumption function  $C^{*(28)}$ . On the other hand, if the rich continue to consume of their income the same proportion as before, the function must shift upward to the dotted line parallel to the initial  $C$ . The slope of the function will not change; consumption would rise at the expense of savings<sup>(29)</sup>

So far we have focused on the marginal propensity to consume of the rich. An important question concerns the impact of Islamization on marginal propensity to consume for the economy as distinct from that of the individual income groups. Presumably, this issue has to be addressed to appreciate the nature of a generalized sort of consumption function. Suppose we do not divide people, their incomes, and expenditures as above, but target a proportion  $\mu$  of income  $Y$  on some basis for a per unit charge  $z$  say as income tax or *zakah*. Will it tend to raise or lower  $c$  the overall marginal propensity to consume to say  $c^{*(30)}$  To simplify matters let us drop the intercept  $a_0$  from the traditional function  $C = a_0 + cY$ , and assume, following Khan, that the income not subject to the charge is all consumed. We thus set up:  $C = cY$ . Introducing  $\mu$  and  $z$  into the picture we get:

$$\begin{aligned} C &= c(\mu Y - \mu z Y) + Y - \mu Y + \mu z Y \\ &= c\mu Y(1 - z) + Y(1 - \mu + \mu z) \end{aligned} \quad (6)$$

Dividing through by  $Y$  we get

$$C / Y = c\mu(1 - z) + 1 - \mu + \mu z \quad (7)$$

As the consumption function is made to pass through the origin the average propensity to consume  $C / Y$  equals the marginal propensity to consume. We call the latter  $c^*$ . Thus:

$$c^* = c\mu(1 - z) + 1 - \mu(1 - z) \quad (8)$$

As both  $\mu$  and  $z$  are positive fractions, we finally get:

$$\begin{aligned} (1 - c^*) / (1 - c) &= \mu z < 1 \\ \text{This yields } c^* &> c \end{aligned} \quad (9)$$

It comes about that any charge on income of the people is likely to raise the marginal propensity to consume in any economy. Mainstream consumption models usually have a short-run perspective to fit into a stabilization policy frame. So, their assumption of a constant  $c$  in the face of volatile uncertain economic conditions is understandable. But if one looks at  $c$  in the context of long-run growth strategies for

(28) Following Fig.1 let the initial consumption function be  $C = a_0 + a_1 YU$ . This gives  $a_1 = (C - a_0) / YU$ . Now introducing  $E_2$  into the picture we get Islamic function  $C^* = (a_0 + E_2) + AU(YU - E_2)$ . If aggregate consumption in the economy remains unchanged i.e.  $C = C^*$  and  $AU$  is the new propensity to consume of the rich, then  $AU = (C - a_0 - E_2) / (YU - E_2)$ . Putting the right hand sides of the two equations as an inequality, one can easily find that  $AU < a_1$ . A little algebraic manipulation will show that the short fall is equal to  $E_2(1 - a_1) / (YU - E_2)$ . The reader can verify the results using the following imaginary data:  $YU = 1000$ ,  $a_0 = 200$ ,  $a_1 = 0.6$ ,  $C = 800$ ,  $SU = 200$  and  $E_2 = 50$ . With  $C = C^*$ ,  $AU$  works out to approximately 0.58.

(29) In the illustration of n. 30, if  $a_1$  remains unchanged, aggregate consumption would increase by 20 reducing savings by the same amount.

(30) See for example **Iqbal** (1985). He reviews the works of Metwally (1981, 1985) in pp.49-51 as also of **Darwish and Zain** (1985) published in Arabic in PP.51-54. However, his own conclusion on the issue is that "the net effect of Islamic injunctions on the marginal propensity to consume will be neutral i.e. MPC will not be significantly different from a comparable secular economy", p. 59.

developing economies a greater part of our attention must be devoted to what could affect 'c' and how. Muslim countries mostly fall in this category.

Iqbal in his note 'Zakah, Moderation, and Aggregate Consumption in an Islamic Economy' (1985) reviews some of the writings in the area and laments that they do not present any Islamic theory of consumption: they seek merely to explain the effects of Islamic teachings on the existing secular models (p.46). He joins the present writer<sup>(31)</sup> on the point that the effects on consumption of spending in the way of Allah including *zakah* would be expansionary, and of Islamic moderation contractive: thus the net effect can in no way be predicted (p.45). Also, Iqbal makes some welcome refinements in introducing *zakah* collection charges in his model. However, beyond few merits, his note is dotted with serious blemishes and confusion<sup>(32)</sup>.

Interestingly, Iqbal starts with the same equation  $C = a_0 + cY$  he slighted others for using. For maintaining uniformity in expression, we replace his symbols with the ones we have been using in the above discussion. Thus, putting  $\mu$  in place of his  $\beta$  as the proportion of income  $Y$  going to the payers of *zakah*, and replacing his  $\alpha$  with  $z$  as *zakah* rate, we may write his equation 2 (p. 48) for consumption in an Islamic economy  $C_1 (= C^*)$  as under:

$$C^* = a_0 + c (\mu Y - zY) + \delta [(1 - \mu)Y + zY] \quad (10)$$

Here  $\delta$  is, as in Iqbal, the marginal propensity to consume of the *zakah* recipients. Thus, unlike Khan, Iqbal assumes that the *zakah* recipients are able to save out of their incomes. Understandably, he keeps  $\delta > c$ . However, this formulation has one grave error: *Zakah* is payable not on  $Y$  but only on the  $\mu Y$  part of it. With the incorporation of this correction the above equation must read as:

$$C^* = a_0 + c (\mu Y - z\mu Y) + \delta [(1 - \mu)Y + z\mu Y] \quad (11)$$

This error alone has vitiated most of Iqbal's algebraic manipulations. One may find the details in our earlier comments (Hasan 1990) but some we may mention here. To show that moderation – avoidance of *israf* ( $1 - f$ ) – and *zakah* transfers would pull the consumption of the rich in the opposite directions with indeterminate impact – increase or decrease – on  $C^*$ , Iqbal arrives at his equation (34) given below<sup>(33)</sup>:

$$c^* - s = (d - c) \sigma - cf (\mu - \sigma) \quad (12)$$

Here, 'c\*' and 's' are the overall MPCs of the Islamic and secular economies respectively,  $\sigma = z(1 - \epsilon)$ , and  $f$  is a positive fraction<sup>(34)</sup>. Iqbal shows that both the terms  $(d - c) \sigma$  and  $cf (\mu - \sigma)$  in the equation are positive with a common range. The first quantifies increase in  $c^*$  due to the introduction of *zakah* and the second measures the decrease caused by observing of moderation. Thus, whether  $c^*$  will be greater or smaller than  $s$  will depend on the relative values of these terms (p. 57):

$$(d - c) \sigma < \text{or} > cf (\mu - \sigma). \quad (13)$$

(31) Compare with Hasan (1985, p. 81).

(32) We have provided detailed comments on Iqbal elsewhere (See Hasan, 1990 pp.92-100).

(33) For this he multiplies the second term by  $(1 - f)$  in his equation 2 (in 10 above) and divides the result by  $Y$  to obtain  $c^*$ . Likewise, he divides the secular consumption function – his equation (6) by  $Y$  to get  $s$ . To obtain  $(c^* - s)$  Iqbal takes the difference of the right hand side of the two equations (p. 55).

(34) Here  $\epsilon$  is the fraction of *zakah* transfers that may return to the rich, Iqbal believes, through the exchange process. To us this is one of the confusing complications Iqbal introduced in his already complicated model.

The difficulty with this formulation is that its derivation process rests on the same error as mentioned above i.e. using  $zY$  instead of  $z\mu Y$ . Allowing for the correction, equation (13) reduces to:

$$(d - c) \sigma < \text{or} > cf (1 - \sigma) \quad (14)$$

Note that in the new equation  $\mu$  the proportion of income going to the rich no longer plays a role in deciding the magnitude or direction of the difference ( $c^* - s$ ). It plays a role in fixing the *position* of the line in the plane only *after* the difference becomes known. This is clear from the following correction of equation (33) in Iqbal:

$$APC_I - APC_S = \mu [(d - c) \sigma - cf (1 - \sigma)] \quad (15)^{(35)}$$

Again, for clarity one can straight away use 'f' as a positive fraction for *israf* rather than his (1-f) for specifying moderation. Inserting 'f' in our equation (6) and solving it we get the modified version of equation (8) above as:

$$c^* = c\mu f (1 - z) + 1 - \mu (1 - z) \quad (16)$$

Simplifying, we get  $c^* = 1 - \tilde{A} (1 - cf)$ , where  $\tilde{A} = \mu (1 - z)$  is a constant. Clearly, if  $z$  the spending in the way of Allah increases,  $\tilde{A}$  would fall and  $c^*$  rise. On the other hand,  $(dc^* / df) > 0$  i.e. increase in moderation or decrease in  $f$  would tend to lower the overall propensity to consume in the Islamic system, but it would in no way ensure that the tendency would more than neutralize the impact of  $z$  on  $c^*$  and push it below the secular  $s$ . Notice that  $(dc^* / dc)$  is as well positive. The implication is that if the current tendency among the rich of Muslim societies to emulate Western consumption patterns continues the impact of moderation on  $c^*$  may be ineffective.

#### 4. Consumption and Social Welfare

The income distribution models that we have in Islamic economics incorporate consumption usually by proxy in the sense that it is a reverse image of savings<sup>(36)</sup>. Islamic economists have shown almost complete ignorance of some far reaching developments that have been taking place over the past decades in the mainstream economics in general and in the treatment of consumption in particular. It is of course well recognized in the literature that to the extent transfer payments, *zakah* and *infaq*, increase labor productivity, and enlarge the size of the market, the rise in consumption they cause is a sort of *real* investment and contributes to making up for the possible fall in savings. But the metamorphosis we are talking about is different.

There is an ever-increasing interface between economics and other social sciences—sociology, political science, psychology, even ethics. Their mutual understanding, areas of common concern, and shared research interests are on the rise. Mainstream economics is

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(35) The subscripts I and s indicate Islamic and secular APC respectively. The right hand side of equation (34) in Iqbal giving the difference of the two MPCs remains the same as in (33) for he is dealing with linear functions (p.55). For relationships between various variables in the equation and their diagrammatic depictions see **Hasan** (1990) pp. 94-96.

(36) For a brief comment on the nature of these models and their limited achievements see **Hasan** (1985, p.121).

moving closer to the Islamic insistence on inter-disciplinary approach to the seeking of knowledge, use of ethical filters, and giving a human face to economic relations between sectors, groups, and economies<sup>(37)</sup>. Working within and across disciplines social scientists have begun to seek consensus on the dimensions of well-being and its appropriate measures. The development can have a profound impact on findings regarding relative well-being across groups, and trends therein: the choices can affect conclusions about the consequences of social and economic policies (Beverly, 2002, p. 1).

Notice the effect of these developments on the issue of consumption. Slesnick (2001) produces empirical evidence from the US economy to challenge some of the normally accepted facts in the area. His estimates based on family income data show that living standard in the US has made little improvement over the decades<sup>(38)</sup>, inequalities have increased<sup>(39)</sup>, and poverty remains high. He argues that consumption compared to income is a better measure of economic well-being. It can be spread more evenly over time: people can and do save when income exceeds consumption requirements and can liquidate savings or run debts if income falls below consumption needs. Income elasticity of consumption is in general less than unity. Also, national income figures because of product-mix differences over time and among nations are not so much reflective of welfare as are the data on consumption. On this count too there seems to be a close relationship between consumption levels and social welfare. The presumption lends meaning and content to the Islamic emphasis on the fulfillment of basic needs, restraint on consumption and achieving of distributive justice.

For an objective analysis of the consumption-welfare nexus the two concepts have to be measurable. Slesnick includes in consumption the out-of-pocket expenditures of consumers plus market rental equivalents of owner-occupied houses and durables. For measuring inter-temporal changes in welfare he rejects the consumers' price index in favor of a social cost of living index<sup>(40)</sup>. When standard of living is based on consumption rather than income one finds the elderly having an edge over the young in terms of economic well-being. The finding is relevant to recent debates among the sociologists concerning economic hardships across the course of life.

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(37) It is time that Islamic economists shed their misconception that mainstream economics is value free, has no altruistic elements in its applications, and is seized with the money making 'economic man' alone. This is not to say that all is now well with mainstream economics. Its own proponents are its more informed and vocal critics. The point is that things in some ways are changing, even if slowly, in a welcome direction from an Islamic viewpoint.

(38) Aspiration gaps, which consumerism creates, are eating into the vitals of American life. In middle class families parents experience an almost threatening pressure to keep up, both for themselves and their children. Eighty-five percent of population cannot earn the six-digit figure income necessary to support the upper middle class life-styles. Inability to save much is a constant source of stress and worry. Somewhere between a quarter and half of all households lives hand to mouth: bankruptcy rates continue to set new records, rising from 200,000 a year in 1980 to 1.4 million in 1998 (Schor, 2003, p.6).

(39) In the US, distribution of income and wealth has shifted decisively in the direction of top 20% since 1970s: their income share rose from 41.4 % in 1979 to 46.8 % in 1996. Likewise, the share of wealth they controlled went up from 81.3 % in 1983 to 84.3% in 1996.

(40) The social cost of living index is the ratio of the minimum expenditure needed to attain a given level of welfare at one set of prices to the minimum expenditure needed to attain the same level of welfare at a different set of prices. For technical details see Nagar and Das, 1988, Section 12.5 pp. 301-305.

In contemporary American culture consumption becomes as authentic as the level it attains. Advertisements, getting a bargain, garage sales, and credit cards<sup>(41)</sup> have become the well-entrenched pillars of the American way of living. The shopping mania unloads considerable unease: there is growing preoccupation and anxiety with getting and spending. There is realization of losing touch with more worthwhile values and ways of living. Unfortunately, the feeling of discomfort did not sharpen enough to cohere into an effective weapon against the proliferating consumerism.

The resurgence of interest in the theory and evolving patterns of consumption at the macro level possibly draws inspiration from the much debated life cycle theorem in the literature and the criticism of income hypothesis on which it rests<sup>(42)</sup>. However, two of its dimensions – environmental and ethical -- are certainly of recent vintage.

The in fashion discourse on sustainable development is not clear on what it is that has to be sustained: long-run economic growth, intergenerational equity in distribution of incomes and wealth, or the quality of environment. A closer look at the first two versions would reveal that their requirements make them converge to the third – sustainability of the environment. The greatest source of environmental degradation can be traced to the grossly uneven consumption levels within and across nations; about 15% of the population of the world living in the developed countries enjoy no less than 77% of the global output. Now, even if the rich could remain content with their current consumption levels, global production of goods and services must increase to ameliorate living conditions and dent poverty of the bulk of world population. Output expansion cannot be slowed. These facts pose some serious challenges for mankind.

As availability of resources invariably lags behind their demand and bulk of them are located in the developing countries, the interests of the rich and the poor of the world conflict. The increasing wars, clashes, and violence witnessed around the world today are but manifestations of this conflict – the underlying factors are essentially economic. Again, as production must increase, pollution volume cannot be reduced even though its generation could be slowed down. If the cake and the poison are both to grow, how the rich and the poor would share each must be a bone of contention<sup>(43)</sup>. The powerful rich want most of the cake but little poison. It reminds us of the universal and eternal nature of the Qur'anic injunctions. The Scripture expresses abhorrence for what we now call consumerism in these words: “And those who do *kufr* (mischief) avail of material things and eat as do the animals; their abode is Hell” (47:12)<sup>(44)</sup>. Consumerism – excessive attention to materialistic desires – breeds egoism that ultimately brings in more of frustration and futility than the bliss of fulfillment.

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(41) Consumers' credit is fast becoming the most lucrative business for the commercial banks in the West. Islamic banking system too wants to follow suit without caring to know welfare implications of the credit card culture – the impact of borrowing from the future to spend now. There is a lot of imitation without much discretion.

(42) For a brief presentation of this criticism see for example **Hasan** (1990, pp. 98-99).

(43) Caliph Ali b. Talib explaining the *Shari'ah* requirement of keeping harmony in the nature-man relationship observed: partake of it (nature) with joy as long as you are a benefactor not a corruptor, a cultivator not a destroyer.

(44) For, animals alone have no instincts save for eating and mating. To focus further on the point, Islam strictly prohibits eating or drinking in a standing mode, as that too is demonstrative of animal instinct.

Interestingly, the need for ethical and moral controls on behavior of economic agents is of late being recognized in mainstream researches<sup>(45)</sup>. In the area of consumption a variety of issues are often defined as ethical concerns including environmental care, health and safety risks, fair trade, labor conditions, animal welfare, and human rights. Informed research into motivations for ethical consumption is relatively scarce, in Islamic economics as well. We can proceed here by raising two questions: how do academics, policy makers, and organizations understand ethical decision-making? Second, what sorts of ethical conduct would Islamic norms encourage in the area of consumption?

Some sort of ethical values determined by the cultural patterns of people are already implicit in their routine consumption behavior in all societies. Examples are priority for the fulfillment of basic needs, equitable distribution of consumption among the family members, spending on religious and social ceremonies, saving for the rainy day, some altruistic expenditure and so on. Researchers in mainstream economics seek to collect and examine data on how such values tend to become the object of explicit policies and campaigns for their own reinforcement; and how far such reinforcement improves the attitudes of people to continue manifesting these values in their daily lives<sup>(46)</sup>. Such research, albeit useful and revealing, is of a matter-of-fact sort, dealing mostly with static circular relationships; it has little reformative content.

Scholars in other social disciplines – sociology, anthropology, cultural studies, and human geography -- have moved a step further. They demonstrate that consumption is one area where autonomous action to discipline the market is required as the market allocates resources and distributes commodities in accordance with the purchasing power of people, not their needs. Individuals require reflective monitoring of their own conduct: they must indulge in fashioning of relationships between themselves and others. This is the message of Islamic economics as well but with a difference.

Choice of behavioral norms or their modification is much less flexible in Islamic economics compared to secular dispensations. It has to observe the confines of Shari'ah, and is regulated by its foundational all-pervading notion of a *Amanah*. These norms have been extensively discussed in writings on Islamic economics. The main ones relevant to the present discussion we have already mentioned in Section 2 and need not repeat them here. The major difficulty is not with the knowledge of the norms; it is with their *measurable* conceptualization. Frivolous expenditure, *israf*, moderation, legitimate requirement, basic needs fulfillment and so on all need quantification. It is a difficult task, but by no means impossible. Many of the value-loaded concepts – normal profit, minimum wages, productivity, efficiency, quality of life and the like – have been provided measurable forms in mainstream economics. Islamic economists too have quantified in money terms some of the concepts such as *nisab*, or the fulfillment of basic needs. Let us take up this task in a more earnest way forming research teams, if not individually.

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(45) The economic value of ethical conduct for corporate strategy in purchasing, retailing and policy-making is well established and is likely to grow. See, for example, **Bernett et al** (2003, p. 14).

(46) See, for example, the outlines of such a research being conducted by Clive Barnett and others and expected to be completed by September 2005



## 5. Concluding Remarks

The foregoing appraisal of the treatment of consumption in Islamic economics over the past 26 years or so has been rewarding in several ways. The scholars have rightly followed an evolutionary approach in preference to puritan formulations. They have based their researches on mainstream concepts attempting to modify them to meet the Islamic requirements. Even though conceptualization has not always been logical one comes across some worthwhile discussion on basic Islamic notions like needs, moderation, impact of pursuing Islamic norms on propensity to consume, savings and investment and the like.

There have also been laudable efforts to have a look on basic macroeconomic models in the Keynesian tradition and incorporate into them some key Islamic variables and the consequences of disaggregating consumption and income using *nisab* as the dividing line. However, some of the conclusions are presumably overdrawn and do not stand the test of logic. For example, the argument that there is a *trade off* between the pleasures of this world and the gains in the hereafter is not convincing. It is also purely presumptive to insist that moderation would more than make up the fall in savings occasioned due to transfer of income from the rich to the poor through *zakah* mechanism.

There seems to be a lot of confusion concerning the impact of these transfers on propensity to consume. The clarification of this point provided in the paper is perhaps one of its main contributions. It also demonstrates in this context that for the economy as a whole the *difference* between the two MPCs i.e. before and after the introduction of *zakah*-moderation mechanism into the picture is independent of the division of income between the rich and the poor.

The paper draws attention to certain developments in mainstream economics and other social sciences that are welcome from an Islamic viewpoint. Of special interest is the integration of environmental and ethical issues in the discussion on consumption. I think Islamic scholars will do well to keep track of these welcome developments.

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## معالجة الاستهلاك في الاقتصاد الإسلامي: تقييم

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**المستخلص:** هذه الورقة هي محاولة لتقييم أدبيات دالة الاستهلاك الكلي في الاقتصاد الإسلامي. تقدم الورقة نظرة سريعة على العناصر الأساسية للمفهوم وتوضح عددا من الاصطلاحات مثل الرغبات والحاجيات، ندرة الموارد، سلة السلع، وكفاءة المنفعة وتعظيمها بالنسبة للمستهلك. وهذه الإيضاحات تحاول سد الفجوة بين الصياغة الجزئية والكلية للموضوع.

فتبرز الورقة بعض النماذج الكلية والمختارة التي تعتمد على توزيع الدخل على أساس النصاب بين الفئات مرتفعة الدخل وتلك المنخفضة الدخل في المجتمع من أجل تحليل تأثير الزكاة على النمو الاقتصادي من خلال تأثيرها على الاعتدال في الإنفاق عبر نظام الادخار/ الاستثمار. وخلافا للمقولات المبنية على النماذج، فإن التأثير الإيجابي للأساليب المنطلقة من مقومات إسلامية على المتغيرات المدروسة غير مؤكد.

وأخيرا، فإن الورقة تهدف إلى جذب الاهتمام إلى بعض التطورات الأخيرة في معالجة موضوع الاستهلاك في الاقتصاد، وكذلك توجيه النظر إلى الاهتمامات المتنامية حول هذا الموضوع في العلوم الاجتماعية الأخرى. إن هذا المنهج المبني على العلاقة المتداخلة بين العلوم المختلفة يهدف إلى فصل الاستهلاك عن الدخل وربطه بدلا من ذلك بالثروة. كذلك فإن هذا المنهج أيضا يبرز الأبعاد الأخلاقية والبيئية. ومن المؤمل أن يؤدي ذلك إلى التقريب في معالجة الاستهلاك في النظامين الاقتصاديين الإسلامي والتقليدي.