Market mechanisms in conventional economics and Islamic Economics

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Abstract

This article describes the market as a meeting place between demand and supply for the type of goods or services. In a capitalist economic system, buyers and sellers bargain with each other to determine prices that give freedom to the market and the government must not intervene which can disrupt the market balance. While the socialist economic system has a view by eliminating the role of markets and the government plays an active role in resolving and regulating all economic problems. In Islamic economics, the market is left freely or the government distorts the existence of a market mechanism. Using a comparative approach to the existing economic system in the world, this article concludes that the Islamic economic system combines market freedom and the role of government that emphasizes the principle of maslahah (goodness), which is a condition of market justice that emphasizes the fulfillment of people's needs in achieving welfare (falah).

Keywords: market mechanism, capitalism, socialism, Islamic economics, falah
JEL classification: E02, I31, P10, P20, P51

A. Background

According to Teteng et. al., the failure of modern economic systems (capitalists and socialists) to realize desirable goals such as meeting basic needs, full employment opportunities, and equitable distribution of income and wealth has encouraged economists to look for alternative economic systems that can overcome these problems.1

Economic development is very dependent on the market mechanism, where a simple market mechanism is the occurrence of transactions between sellers and buyers in a particular place, this is due to the demand and supply factors (demand and supply). Islamic economic leaders explained that the market mechanism is not only determined by demand and supply factors. As Abu Yusuf said that there are factors that cannot be seen by humans, namely the factor of God's intervention in all things, including the market mechanism. Another matter was discussed by Ibn Taymiyyah who underlined that there might be a rise and fall in prices because of market players who are fair or can act unfairly.2 Of course this is contrary to the opinions of Western economists who focus on the market mechanism alone, namely the occurrence of up and down prices of pure goods because supply is lacking, so demand rises, or vice versa. So says Adam Smith, David Ricardo, or Jhon Maynard Keynes. This can be

distinguished which brings blessings in the form of falah (benefit in the world and the hereafter) or just pursuing material purely in the world.

According to Yenni Samri Juliati Nasution\(^3\) said that, the ideal market according to the capitalist economic system is a free market (perfect competition market), because if individuals are freed to fulfill their own interests in their own way then the interests of society as a whole will be achieved, and the government at all may not intervene or interfere in it because it will disrupt the balance in the market. Whereas the socialist economic system has the opposite view, namely eliminating the role of the market and the government which plays an active role in resolving and managing all economic problems. The government plans, implements and evaluates its own economic policies.

The market is the meeting of demand and supply for one type of goods or services. In the market between buyers and sellers mutually bargain to determine the price of various types of goods. In economic analysis, the notion of markets is not limited to a particular place but covers an area, country and even the international world. The market for rubber and tin, for example, is not intended as a place of sale and purchase of rubber or tin in a particular village or region but includes interactions between producers and buyers of rubber or tin in all corners of the world.

Markets where buyers and sellers interact can be divided into two types, namely the goods market and factor markets. The goods market is a place where buyers and sellers of an item or service interact to determine the amount and price of goods or services that are traded. While the factor market is a place where entrepreneurs (buyers of production factors) interact with owners of production factors to determine prices (income) and the number of factors of production that will be used to produce the goods and services requested society.\(^4\)

The market mechanism can allocate factors of production quite efficiently and can encourage economic development because it has some good. The goodness of the market mechanism is that the market can provide more precise information, the market encourages to develop business activities, the market gives encouragement to obtain modern expertise, the market promotes the use of goods and factors of production efficiently, the market gives high freedom to the community to carry out economic activities.\(^5\)

This paper will examine the market mechanism from the perspective of conventional economics and Islamic economics, so that it is known comparatively the aspects that arise and process in it, especially in terms of market ethics, prices, demand and supply, and implementations that might be realized for a fair market mechanism to achieve falah for humans today.


\(^5\) Lihat pembahasan harga dan pasar dalam karya Abdul Azim Islahi, Contributions of Muslim Scholars to Economic Thought and Analysis(11-905 AH/632-1500 AD) (Jeddah: Scientific Publishing Centre, King Abdulaziz University), 2005.
B. Literature Review

The study of market mechanisms is mostly carried out by experts, especially from the comparative aspects of the world economic system, namely capitalism, socialism, and Islamic economics. Zubair Hasan⁶ in Markets and The Role of Government is an Economy for Islamic Perspective explaining the market in a historical perspective and the role of markets in the free enterprise economy. This article confirms the market failure and the main role of the government which is expected to regulate the market from an Islamic perspective.

Hamid Hosseini⁷ in Understanding the Before Market Mechanism Adam Smith: Economic Thought in Medieval Islam insists that medieval Muslim scholars have had a thorough understanding of market mechanisms. This article reveals that Islamic society in the Middle Ages had important market institutions and their functions were understood by traders and practitioners as well as by Islamic jurists and Muslim philosophers.

Abdul Azim Islahi⁸ in Ibn Taimiyah's Concept of Market Mechanism explained about the concept of market mechanism according to Ibn Taimiyah. This article is enough to explain the market and market mechanisms in an Islamic economic perspective which emphasizes that market prices are an important part of a mechanism that should not be intervened by the government.

Idris Parakkasi and Kamiruddin⁹ in Analysis of Prices and Market Mechanisms in the Islamic Perspective explains Islam in regulating prices and market mechanisms emphasizing natural market systems. The Islamic system refuses to set prices by the authorities, because Allah determines it. The price formed must be in accordance with the supply power and market demand. Therefore, the price of goods must not be determined by the government.

Yenni Samri Juliati Nasution¹⁰ in the Market Mechanism in the Islamic Economic Perspective explains that the market is a natural mechanism for the exchange of goods and services. Market prices are formed by various factors which then form the demand and supply of goods and services. Consumer demand is influenced by many factors, such as price, consumer income, tastes, expectations, and the level of society.

Some of the above writings explain the market mechanism in Islamic capitalist, socialist, and economic perspectives. The author in this case emphasizes more on the comparative aspects of the three economic systems, so that it can provide new insights in analyzing market mechanisms and the role of government in them.

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⁶ Zubair Hasan, Markets and The Role of Government in an Economy For Islamic Perspektive (INCEIF : The Global University in Islamic Finance, 2008), pp. 4-5
⁷ Hamid Hosseini, "Understanding the Market Mechanism Before Adam Smith: Economic Thought in Medieval Islam," 104-123.
C. Results and Discussion

1. Definition of Market Mechanism

According to Idris, the Islamic system pays attention to the perfection of the market mechanism. Perfect market mechanism is the resultant of forces that are mass and impersonal, which is a natural phenomenon. Perfectly competitive markets can produce fair prices for sellers or buyers. Because if the market mechanism is disrupted, a fair price will not be achieved. Fair prices will encourage market participants to compete perfectly. The Islamic system strongly encourages the concept of prices that are fair, open and in accordance with a perfect market mechanism.11

The concept of market eating in Islam can be referred to the Rasulullah's hadith as stated by Anas r.a, in connection with the increase in prices of goods in the city of Medina. The word of the Prophet (peace be upon him) which means: "From Anas Ibn Malik ra. Said: Commodity prices went up in the days of the Messenger of Allah, then the Companions complained to him while saying: O Messenger of Allah, the price of goods is expensive, then set a benchmark price for us. Then the Messenger of Allah answered: Surely Allah has set the price (Dzat) that holds back and who distributes rizki, and in fact I hope that I can meet Allah SWT in the condition that none of you sue me for tyranny which causes bloodshed and wealth."12

This is the Islamic economic theory of prices. Rasulullah saw. in the hadith does not determine the price. This shows that the price provisions are left to a natural market mechanism. Rasulullah saw. refused the offer and said that the price on the market should not be determined, because God was the one who determined it. The sayings of the Prophet contain the understanding that the market price is in accordance with the will of Allah, the sunnatullah or according to the law of supply and demand. Islam places the market in an important position in the economy.

Economic practice at the time of the Prophet and Khulafaurrasyidin showed a large market role. The Messenger of Allah greatly appreciated the price formed by the market as a fair price. He rejects the existence of price intervention if the price changes occur because of a fair market mechanism. But the market requires morality (fair play), honesty (honesty), openness (transparency) and justice (justice). If these values are enforced, there is no reason to reject market prices. The companions and priests of the school of thought also gave their views in understanding the hadith, and the reality of the policy of the Prophet Muhammad.13 in addressing the dynamics of trade commodity prices, as follows:

First, the Caliph Umar Ibn al-Khattab argued that in protecting the rights of buyers and sellers, Islam obliged the government to intervene in prices, if price increases were caused by distortions in supply and demand. Umar Ibn al-Khattab once rebuked a merchant named Habib ibn Abi Balta'ah for selling dry wine at below market prices while saying, "increase the price (your merchandise) or you leave our market."

Secondly, Imam Abu Hanifah and Imam Malik ibn Anas allowed the standardization of the prices of certain commodities with the main condition that the standardization or pricing was intended to protect the interests of the majority of the people.

Third, Imam Shafi‘i and Ahmad ibn Hanbal argued that the government did not have the right to set prices on the grounds that: the Prophet never set the price even though the population wanted it. Pricing is an injustice (dzulm) which is prohibited, because this issue involves someone's property, while everyone has the right to sell their trading commodities at any price based on an agreement between the seller and the buyer.

In Rachmat Syafei’s view, prices only occur in contracts, namely something that is given up in the contract, both less, greater, or equal to the value of the goods. Usually, prices are exchanged for goods which are carried out by the contracting parties. According to Ibn Taymiyyah quoted by Yusuf Qardhawi: "Pricing has two forms, there are permissible and some are forbidden. First, tas'ir is a form of unjust pricing, and this is prohibited in sharia. Both prices are fair, namely prices in accordance with the rules of supply and demand and market mechanisms."

If pricing is done by forcing sellers to accept prices that they are not ridhai, then this action is not justified by religion. However, if the price determination raises a justice for the whole community, such as establishing a law not to sell above the official price, then this is permissible and must be applied. According to Qardhawi, if the trader holds an item, the buyer needs it with the intention that the buyer wants to buy it at a price twice the first price. In this case, traders must voluntarily accept pricing by the government. The authorities must set the price.

Thus, mandatory pricing is made so that traders sell prices that are appropriate for the upholding of justice as requested by Allah. According to Ibn Taimiyah, prices are determined by the strength of demand and supply. The size of the price increase depends on the magnitude of changes in supply and or demand. If all transactions are in accordance with the rules, the price increase that occurs is God's will.

According to Adiwarman Karim, price determination is carried out by market forces, namely demand strength and supply strength. In the Islamic concept, meeting requests with these offers must occur willingly and willingly, no party feels compelled to make a transaction at that price level. So the meeting point between demand and supply that forms the price of equilibrium should be willing and willing and without coercion from either party.

Teteng et al said that the market mechanism is certainly not a factor of production, because where there are consumers there must be producers, the verses about this product have been hinted by Allah SWT in the Qur'an Surat al-Hadid (57) verse 25 which means: "Truly We have sent our apostles with bukii-proof, and We have sent down with them Al-Kiiab and the balance sheet (justice) so that people can carry out justice. And we create iron in which there is great strength and benefit for mankind, ( so that they may use the iron) and

so that God will know who helped (His religion) and His Apostles when Allah did not see it. Indeed, Allah is Strong, Mighty. \(^{17}\)

In the verse it is clear that Allah has issued a balance sheet (justice) to humans in a market mechanism system, wherein (QS-Al-Syu'ara, 26: 183) conducting a transaction must certainly be based on justice, that is between producers and consumers. In addition, the Prophet said, which means: "Two people who buy and sell have the right to vote while not separated from each other, until they are honest and explain, then both are blessed in buying and selling, but if they hide and lie to each other, they will be eliminated." (HR Bukhari Muslim).

Here it is explained that between the seller and the buyer there must be an attitude of mutual lying, but openness in conducting a transaction, Islam is very concerned about the economy. So, the market mechanism is determined by the demand of consumers who want an item, producers who provide goods, and added by the government that controls the market mechanism system in terms of regulations (this is specifically applied in Indonesia). In other words, the existence of an exchange transaction which is then referred to as trade is a main requirement of the passage of the market mechanism.

The majority of people in Ibn Taymiyya's era assumed that the increase in prices of goods was identified as an act of injustice and illegal acts of the seller, or the possibility was caused by market players who manipulated prices (speculators) \(^{18}\), then Ibnu Taimiyah rejected the assumption of most people at the time Therefore, the assumption is expressly denied and that the price is determined by the strength of demand and market supply (demand and supply).\(^{19}\)

More specifically, he said that price fluctuations are not actions or injustices of some people involved in a transaction, can be identified if deeper causes are decreasing supply due to production inefficiencies, decreasing decreases in the number of exports (from outside one region to another ) on the requested goods or also the pressure from the market itself. If the demand for goods increases, while the supply decreases, we can be sure the price of the item will increase, or vice versa. And if scarcity and abundance of goods may be caused by fair actions or unfair actions from the market participants themselves.\(^{19}\)

### 2. Types of Markets and Principles in the Market Mechanism

In Yenni's view, the types of markets in terms of sellers are classified as follows :\(^{20}\)

a. Perfect competition. Perfect competition is the most ideal market structure, because this market system is considered a market structure that will ensure the realization of activities producing goods or services that are high (optimal) efficiency.

b. Monopoly. In Islam the existence of one seller on the market, or the absence of a competitor, or small market competition, is not forbidden. Anyone can trade without caring if he is the only seller or there is another seller. So it’s a monopoly in the literal

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sense, it's okay. However, whoever he is may not do ihtikar. Islam does not allow personal monopoly or control, which might be detrimental to society.

c. Monopolistic. In the monopolistic competition market there is an element of competition based on the fact that there are many companies or producers where the actions of one producer will affect other producers. But there is also an element of monopoly where companies produce goods that are homogeneous but each has a significant difference, so consumers have a choice.

d. Oligopoly. The Oligopoly Market shows that there are producers who are limited or few in number and there are very many consumers.

If viewed from the side of the buyer, the types of markets can be divided into monopsony, oligopoly, and perfect competition.

The market is the meeting of demand and supply for one type of goods/services, namely the position where there are certain items that consumers want and can afford to buy. In Idris's view, the concept of a market mechanism in Islam is built on the following principles:

First, the willingness (Ar-ridha) that every transaction done must be based on the willingness of each party (freedom contract). This is in accordance with the Qur'an Surah An-Nisa verse 29: "O you who believe! Do not eat your neighbor's possessions in the wrong way, except by the way of business that is acting with love among you. and do not kill yourself; Verily, Allah is Most Merciful to you."

Second, honesty, honesty is a very important pillar in Islam, because honesty is another name of the truth itself. Islam strictly prohibits falsehoods and frauds in any form. Because of this value of truth will have a direct impact on the parties who conduct transactions in trade and society at large.

Third, openness (transparancy). Implementation of this principle is a transaction that is committed to be true in the disclosure of the will and the actual situation of good heart, speech or deed.

Fourth, justice (justice), puts all market mechanisms in proportion, condition and background.

Fifth, trust, that is to avoid speculative pricing so the price is not fair.

3. Islamic Market Distortion

In the Islamic concept, price determination is carried out by market forces, namely the power of demand and supply must be willing to be equally willing, no party feels compelled or deceived by the error of the object of the transaction in certain goods transactions (Q) at the price level (P) certain. Islam guarantees a free market where buyers and sellers compete with each other with the flow of information that runs smoothly in a framework of justice, that is, there is no (both individuals and groups, producers and

consumers, especially the government) that is tyrannical or wronged. These are ideal situations. But in reality, the ideal situation is not always achieved, because there is often interference or interruption in the ideal market mechanism. This interference is called market distortion (market distortion).  

On the outline, Islamic economics identifies three forms of market distortion, namely engineering supply and engineering demand, tadlis (fraud), and taghrir (from the word gharar or uncertainty, confusion). In Islamic Economics, bidding engineering (false supply) is better known as ihtikar, while demand engineering (false demand) is known as bai ‘najasy. For tadlis (fraud or unknow to one party) there are 4 forms, namely: fraud concerning the quantity of goods (quantity), quality of goods (quality), price of goods (price), and time of delivery (time of delivery). Whereas taghrir (confusion, uncertainty or unknowing both parties) also have 4 forms concerning quality, quantity, price, and time of delivery of goods.  

4. Imperfections and Failures in the Market Mechanism  

Market imperfections can occur due to:  

a. Structured deviations or forms of market organization will disrupt the market mechanism in a systematic and structured way too. The intended market structure is monopoly, duopoly, oligopoly and monopolistic competition. In a monopoly for example, there is an obstacle to entry barriers for other entrepreneurs who want to enter the market so that there is no competition between producers. Monopolistic producers can set high prices to get profits above normal (monopolistic rent). Likewise, other market forms, although the effects of distortion are not as strong as monopolies, will distort the operation of a perfect market.  
b. Unstructured irregularities. In addition, there are also incidental and temporary factors that disrupt the market mechanism. Some examples of this are intentionally hoarding efforts to hinder the supply of goods so that market prices become high (ihtikar), the creation of quasi-demand to raise prices (najasyi), fraudulent quantity, quality, price, or delivery time (tadlis) make the price above the normal price (ba’i al-present lil badi) and others.  
c. Information imperfections and adjustments Information is important because it is the basis for decision making. Producers have an interest in knowing how much market demand and price level, etc. so that they can offer their goods accurately. Likewise with consumers who must know the level of market prices that apply so that they can determine their demand accurately too. The Messenger of Allah, has prohibited imperfections in information, for example by blocking transactions at market prices (talaqi rukhban), taking high profits by utilizing consumer ignorance (ghaban fa his), and so on.  

In the absence of perfect market competition it fails in a number of fields. Pursuing personal interests often drives slices between individual and social interests; it causes market failure in many fields. Indeed, there is no scarcity of literature in the mainstream economy

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itself which expresses anxiety at free market performance and in mentioning their weaknesses.

The market produces and distributes goods and services that are not in accordance with the hierarchy of human needs but are comparable to the orders of individual purchasing power. The distribution of income and wealth is very uneven within and between countries, there is insufficient production of goods to meet all the basic needs of life - food, clothing and shelter - for the poor while luxurious for rich groups that are far more small is made abundantly. In other words, the allocation of resources is distorted. The economic idea of efficiency requires rethinking.

The well-known marginal productivity theory does not distribute income according to the contribution of each factor to total output even if competition in the market is a perfect factor. Because, the demonstration that a factor is paid equal to the value of its marginal product to income does not in itself prove that the marginal product determines that payment because it is not a contribution of factors to output but its rarity relative to other factors that determine both marginal products and gifts. Remember also the Marshall dictum that the use of marginal and marginal costs does not determine value but is determined alone along with the value of the general strength of demand and supply.

The market only provides personal items. Such items have two different characteristics: First, if one unit is purchased by A, the same unit cannot be purchased by B. This we call the exclusion principle. Second, if C uses commodities, D cannot use them simultaneously; For example, if I eat apples, you also can't eat them. We call this the competition principle. However, many items do not have exception or competition characteristics but people may need them. Non-excludability and non-rivalry can cause problems for the production of these items. It is said that they can cause examples of market failure, because self-interest, the driving force of the system, may not allow their production in the desired amount. These goods are provided by the government and are called public goods, the provision of civil administration or defense is a prime example.

The market is included in the production costs only payments made to goods and services where the law recognizes the property rights of individuals or institutions. Many natural resources such as fresh air, water, forests, and the atmosphere that remain a gift of the outdoors are also used in the production process to release or store waste which endangers all forms of life. Their increasing volume has long traversed the absorption capacity and self-cleaning of natural agents and environmental damage has brought planet Earth to the brink of disaster. Environmental goods also have the nature of non-exclusion and non-competition but most cannot be treated as public goods. The balance and proportion that God creates in natural phenomena (the Qur'an refers to such balance and proportions many times) human beings have damaged by impunity only to deal with disasters. It is now widely recognized that environmental goods must pass through the market so that payments for their use become part of the cost of production. This implies an expansion of the concept of scarcity. But how to do it is still a question without a workable answer.  

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26 Zubair Hasan, Markets and The Role of Government in an Economy For Islamic Perspective, pp. 4-5.
5. The Role of the State in the Market Mechanism

Because the assumption of harmony between individual and social interests is not real, markets tend to, as we noted, falter and fail in many fields. And, the evidence that markets can fail to ensure efficient and fair results is a general justification that is advanced for government intervention in free markets. Economists use models and theorems to analyze the causes of market failure, and possible ways to improve them when and when they occur. The analysis plays an important role in many types of public policy decisions. However, some types of government policy interventions, such as taxes, subsidies, takeovers, bailouts, wage and price controls including regulations to correct market failures can also lead to inefficiencies in resource allocation or in income distribution.

Thus, it is said that often there is a choice between imperfect results, namely imperfect market results and imperfect government results. Islamic economics can use mainstream analysis of market failures and corrective actions with profit even if selectively and with modification, if needed. However, Islam departs from the main position in a crucial way in many problems, therefore, it is necessary to have a broader view of the role of the government.

In the Islamic system, one can see the role of government by referring to (i) market performance (ii) the provision of public goods and (iii) environmental awareness. In Islam, market freedom is desirable but not holy cow. The government can take action to modify or add to market results. The market distributes goods according to the size of individual income. Because income distribution is far more inclined to the rich, even the basic needs of the poor are not satisfied. Public policies can help divert resources to the production of goods especially, the provision of food, clothing and shelter, through appropriate policies.27

The Messenger of Allah. has banned the practice of ihtikar, which is deliberately holding or hoarding goods, especially in times of scarcity, with the aim of raising prices later. From Said bin al-Musyyab and Ma'mar bin Abdulllah al-Adawi that the Messenger of Allah. said: "It is not for people to do the endeavor but to sin". The Messenger of Allah. also said "Whoever damages the market price until the price rises sharply, then Allah will place it in hell on the Day of Judgment." (HR Thabrani).28

Ihtikar practice will cause the market mechanism to be disrupted, where the producer will then sell at a price higher than the normal price. The seller will get a big profit while consumers experience losses. Ihtikar is often translated as monopoly and / or hoarding. Even though ihtikar is not synonymous with monopoly and / or hoarding, in Islam anyone can do business without caring whether he is the only seller (monopoly) or there are other sellers. Storing stocks for supplies is not prohibited in Islam. So, monopoly is legitimate, so is storing inventory. What is banned is ihtikar, which is taking advantage of normal profits by selling fewer goods for higher prices, or the economic term monopoly rent-seeking. So, in Islam a monopoly is permissible, while the monopoly of rentseeking is not allowed.29

In order for the price to return to the market price position, the Government makes various efforts to eliminate this hoarding. If there has been stockpiling of goods, the

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government has the right to force traders to sell the goods at the standard prices that apply in the market. by merchants sold at their capital prices and these traders are not allowed to take profits as a punishment against them. If the traders are reluctant to sell their goods at market prices, the law enforcement authorities (judges) can confiscate the goods and then share them with the people who need them.

The government should monitor and anticipate at any time, so that there is no agreement in each commodity, benefits and services that can be needed by the community. The price of standards that do not burden the community and harm the trader must be integrated, and not to benefit one-sided, community or traders.30

D. Conclusion

The Islamic concept emphasizes that the market must stand on the principle of free competition (perfect competition), but that does not mean that freedom is absolute, but freedom with the frame of sharia rules. And the concept that determines that Islamic markets must be able to guarantee the freedom of entry or exit of a commodity in the market along with its production factors. This is intended to guarantee the distribution of economic power in a proportional mechanism. In order for the market to play a normal (natural) role and ensure its continuity, where market structures and mechanisms can avoid negative behaviors of market participants, Islamic teachings also offer sharia-based moral rules that protect every interest of market participants.

Daftar Pustaka