

Sustainable Economic System: What is Missing in Understanding and Implementing the Islamic Economic System

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After 40 years, the inability of Islamic economics scholars to coherently develop a sustainable economic system is indeed a big question mark on the intellectual capacity of the Muslim world. Introducing Islamic banking worldwide did not prove to the world, desperately looking for an alternative system, that Islamic economics offers that alternative economic paradigm and that an economy working on Islamic principles will be a better choice. The focus given to Islamic banking over the 40 years to prove that Islam has a different economic paradigm has turned out to be counter-productive. The claim that Islamic economic principles potentially defines a sustainable economic system has not materialized. Ninety percent of the population in the Muslim world is unbanked and for them, it does not matter if the banking system in the country is Islamic or interest based. In addition, there are between thirty to fifty percent population in the Muslim world suffering from extreme poverty, hunger, starvation and malnutrition and economic deprivation, desperate to see a system that will take care of their miseries.

There is generally no doubt on the proposition that an Islamic economy has to be basically a market economy (though I understand that a minority view may dispute it). There is no substantial argument to say that the primary sources of Islamic economics, i.e. the Qur'ān and Sunnah do not approve the economy to be a predominantly market economy. While saying this, I hasten to add that the current models of market economies are in fact capitalist constructs because they give undue and unjust status to capital vis a vis other factors of production. Therefore, when I say Islam has nothing against the economy to be predominantly market economy, it does not mean that Islam approves the concept/system that is known as capitalist economy/capitalism. The distinguishing feature of an Islamic economy is neither its being a market economy nor its denial to be a capitalist economy. If we want to identify one distinguishing feature of an Islamic economic system then we should look at the following picture that we get from the Qur'ānic text relating to economic features of an Islamic society.

There are a couple of verses in the Qur'ān referring to the market segment in the economy. The most direct reference to the market segment of the economy is the verse 4:29 that says:

O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent. And do not kill yourselves [or one another]. Indeed, Allah is to you ever Merciful (Qur'ān, 4:29)

There are a couple of verses in the Qur'ān, denouncing *ribā*. The most unambiguous verse that prohibits *ribā* is the verse 2:275 saying:

Allah has permitted trade and has forbidden *ribā* (Qur'ān, 2:275)

Which from one perspective, simply means prohibiting money market while allowing the market of real goods and services.

Compared to this, there are 14 verses before the above verse prohibiting *ribā* that command '*infāq fi sabīlillāh*' and at another 30 places, commandments for *zakāh*, *infāq*, feeding *fuqarā'* and *masākīn* (the poor and the needy). In *sūrah al-Rūm*, in the two verses 38 and 39, half of the latter denounces *ribā* using economic jargon but the remaining part of that verse and the verse before it (38), talks about *ṣadaqah* and its 'economics'. A substantial part of economic activities in an Islamic economic system are required to take place for no explicit worldly gain but only to seek divine pleasure and an increased reward in World Hereafter. These activities while being economic activities, are conducted beyond the market framework –sometimes informally, sometimes secretly and sometimes formally through such institutions as mosques, *bayt al-māl*, *awqāf*, charity organizations, etc. It is not merely the injunction

And in their wealth the beggar and the outcast had due share" (Qur'ān, 51:19)

but it is in all those injunctions laid down in the Qur'ān and Sunnah that emphasize the right of the deprived and have-nots in the resource of the haves and the affluent.

It is an undeniable fact that Islam wants the needs of the deprived and less privileged members of the society to be taken care of beyond the market framework of the economy. This 'beyond the market framework' makes it the distinguishing feature of

Islamic economic system. Despite this emphasis on economic activities beyond market, it is currently not a prominent and visible part of contemporary Muslim economies relative to the market segment or the 'state' segment. Muslims have plenty of resources sufficient enough to alleviate poverty and take care of social welfare in their economies. Affluent ones are willing to spend and so are people at grass roots level. Whenever and whatever such activities are taking place, they are taking place in an informal and unorganized manner often leading to unwanted outcomes. The institutional set up in that segment of the Muslim economies that worked beyond market, along with institutional setup for market segment of the economy, suffered more than proportionately as a result of the fall of the Muslim era and surrendering to the colonial rule around the 18th century. The institutions of *awqāf*, *bayt al-māl*, etc. were the particular victims. The beyond-market activities became increasingly informal and unorganized losing their visible impact on the economy or on economic conditions of the poor segments of the population.

When Muslim economies gained independence from colonial rule, the market segment developed and gained prominence. Institutions such as banks, capital market, stock market, insurance, money market, mutual funds and instruments such as bonds, bills etc. developed rapidly to minimize the moral hazard, information cost, uncertainty, transaction complications and liquidity constraints to let the market segment in the economy grow and prosper and to support efforts at economic development to take place at high speed. Such institutional development could not keep pace with the growing needs of the beyond market segment of an Islamic economy that was meant to take care of the less privileged members of the society. Social progress suffered from the lack of institutional support to overcome the issues such as moral hazard, information problems, transaction modalities etc. In some cases, the state segment tried to fill this gap. Unfortunately, this often led to other unwanted outcomes including inefficiency, corruption, lack of good governance and many other ills of 'ineffective government'.

Without demeaning the efforts that promoted current Islamic banking practice, let me invite the attention of academicians and policy makers to one core element that underlies the development of an

Islamic economy. The efficiency of markets (to economic growth) and institutions beyond market (to achieve distributive justice, and to ensure the haves take care of the have-nots) lies in clearly defining the Islamic system of property rights and strictly enforcing them. We all recognize that the system of property rights not only determines the economic system of a society but it also creates and promotes markets in the economy, makes them efficient, and puts the society on the path of development (World Bank Report, 2000)⁽¹⁾. However, we do not explicitly recognize that the Islamic system of property rights simultaneously determines how the system will take care of the less privileged members of the society beyond market. While the Islamic system of property rights has clearly been defined in the books of *fiqh*, their enforcement only requires legislating them in totality and in the legal system of the Muslim economies. The current legal system in Muslim economies that governs the market segment lacks or contradicts several elements of an Islamic system of property rights. The implementation of that part of Islam's system of property rights that is concerned with the distributive justice and care of the have-nots beyond-market is conspicuous by its absence.

We must realize that Islamic economics does not start from the axiomatic study of human behavior, nor does an Islamic economic system start from Islamizing the documentation features of banking and finance or the mechanical introduction of *zakāh* in a Muslim economy. Let us realize the significance of the implementation of an Islamic system of property rights in totality by putting the economic system of Islam in its correct place. We cannot expect an Islamic economy to come into existence or Islamic economics to be understood and developed in its true shape and spirit unless the economy introduces and implements the Islamic system of property rights. Also, Islamic economics cannot be understood and analyzed scientifically unless the Islamic system of property rights is in actual practice.

In this framework, I would like to emphasize two points for the deliberations during this conference. First, trying to introduce an Islamic concept of capital in the financial market and make it work for the poor

and deprived sections of the population will not succeed. This will not make the economy, Islamic. The existing markets in Muslim economies will not be willing to give away the market power that capital is currently enjoying. When Thomas Piketty (2013)⁽²⁾ suggested that capitalism does not self-correct itself in the interest of achieving greater equality in the society and suggested progressive taxation on capital, Bill Gates opposed it⁽³⁾. Piketty as well as Gates conveniently ignored to mention the special status that capital enjoys in the markets of the capitalist economies which is the main source of inequality. I made my observations on this in detail⁽⁴⁾.

Harvard University economist, Gregory Mankiw also argues that the rich deserve to be rich because they contribute more to the society than anyone else and deplores interventions in the capital market to restrict the privileges of capital in any way⁽⁵⁾. Even Islamic economists when suggesting Islamic alternatives to interest-based banking, want to make sure that capital continues to get what it gets because 'capital deserves it'. The argument on capital and its returns requires a separate forum. For now, let us not spend our energies on stripping capital of its powers and privileges or trying to 'correct' the financial markets. For now, let us concentrate on what can be done, beyond the market, for the less privileged and deprived members of the society.

A market economy would not mind the growing role of the beyond market segment in an Islamic framework. In fact, rich and poor, capital and labor in Muslim economies will usually welcome any effort to strengthen this segment. However, we cannot expect markets in the economy to trigger institutional development to expand a 'beyond market' segment in the economy. The starting point to make a contemporary Muslim economy Islamic, therefore, should not be the so-called "Islamization" of the financial system. The starting point instead should be elimina-

(1) The World Development Report 2000 gave focus on the importance of institutions in development.

(2) *Capital in the 21st Century*, Translated by Arthur Goldhammer, 2014 edition for President and Fellows of Harvard College, USA.
 (3) 13Oct 2014, "Wealth and Capital: Why Inequality Matters" (<http://www.gatesnotes.com/Books/Why-Inequality-Matters-Capital-in-21st-Century-Review>).
 (4) <https://www.facebook.com/IslamicInstitutionalEconomics/posts/1068900516475991>.
 (5) <http://equitablegrowth.org/equitablog/does-the-one-percent-deserve-what-it-gets/>.

ting *faqīr* and *miskīn* (the poor and the needy) from the economy and creating and strengthening beyond market institutions for this purpose. Let this be the objective of macroeconomics in Muslim economies.

Second, no matter how much political institutions try to distribute property rights or how courts or *qadīs* (judges) assign property rights, the market will redistribute the property rights and these rights will end up in the hands of high value economic agents, i.e. the ones having higher economic power in the market. Neither courts nor political institutions nor governments can enforce distributive justice through the assignments or allocation of merely that part of property rights that is meant for promoting the market segment of the economy. For courts, distributive justice is a subjective concept and they would not like the law to take a subjective position. Objectivity requires rule of law. If law does not require distributive justice, the court decision cannot take care of it and political and government institutions' efforts in this respect will also be frustrated by free and competitive markets. When it comes to the issue of distributive justice, the only way is to enforce property rights in the true spirit to develop the beyond market segment of the economy. It is important to understand and research how to motivate the development of institutional arrangements to facilitate the economic activities in the beyond-market segment and allow it to flourish as much as the market segment flourishes.

The geometric progression in knowledge and technology has opened innovative ways for the rapid growth of the market segment of the economy and the institutional network required for it to work efficiently. While this is not happening for the institutional development required for effective functioning of the beyond market segment of the economy, there is a huge potential that needs to be tapped. Historically, there are huge potential resources motivated by religion in Muslim economies waiting to be utilized for gaining divine pleasure,

such as the institutions of *awqāf* and *bayt al-māl*. Unfortunately, they got diluted or have fallen into wrong hands through informal channels. Institutions are not developing to remove the obstacles in the way of mobilizing these resources for the beyond market segment of a Muslim economy in a planned and organized way.

The current state of beyond market segment of a Muslim economy is such that:

- Its size is unknown.
- Its channels are informal.
- It is run at a personal level with no macro vision for the society.
- It is unorganized, so that the flow of resources often ends up in the wrong hands.
- It lacks focus and direction.

We can call it the 'known unknown' segment of a Muslim economy. We know it is there. But we do not know its size, its dimensions, its channels, its directions and its contribution to human wellbeing in the society. This segment remains obscure or undisclosed.

There are reasons to believe that resources potentially available for the beyond market segment are much more than mere 'potential *zakāh*'. My personal estimate is that the potential is 4 to 7 percent of GDP in Muslim dominated economies. This potential needs to be mobilized and channelized through appropriate institutional infrastructure to achieve focused targets in areas of social progress. Revitalization of *awqāf* specifically for this purpose would probably be one such institution that should be on the active Islamic economic agenda for Muslim economies.

With these words, I sincerely wish the conference a success in determining the path towards a sustainable economic system as laid down in the economic teachings of Islam.

Muhammad Fahim Khan obtained his Ph.D. in Economics from Boston University, USA and with more than 40 years of experience in economic policy and planning, teaching and institutional capacity building, Dr. Fahim Khan has written extensively in the field of Islamic Economics and finance. He worked in the Ministry of Planning, *Government of Pakistan* in the area of Economic policy and planning. As one of the Directors of the International Institute of Islamic Economics of International Islamic University, Islamabad, he developed the School of Economics (later International Institute of Islamic Economics, IIIIE). In *Islamic Development Bank*, Jeddah, he developed the research and training capacity of Islamic Research and Training Institute (IRTI) and as Chairman of Riphah Centre for Islamic Business at the *Riphah International University*, Islamabad, he established and developed the Center. He has also advised several national and international bodies on issues relating to economics, finance and Shari'ah. As advisor to the Governor of central bank of Pakistan, he was member/secretary of a high level commission established on the instructions of the Supreme Court of Pakistan to transform the financial system of the country to conform with the Shari'ah. The work of the commission is the basis of the Islamic financial system now in practice in Pakistan. He has been a visiting Research Professor at the Centre of Research in Islamic Economics (now Islamic Economics Institute) of King Abdulaziz University, Jeddah. He also served as Distinguished Faculty Member at National Defence University in Islamabad, Pakistan. He has published 12 books and several articles in international journals. His last publication is *Islamic Banking and Finance in the European Union: A Challenge*. As Chief Editor, he compiled the annual reports for Dubai Centre of Islamic Banking and Finance for 2014; one on Growth, Efficiency, and Stability in Islamic Banking and Finance and the other on Takaful: Global Challenges to Growth, Performance and Governance. He is currently consultant at large in Islamic economics and finance.

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