

Muhammad Akram Khan

What is wrong with Islamic Economics? Analyzing the present state and Future Agenda,
Edward Elgar, UK, 2013, pp. 503.

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The discipline of Islamic economics from an unknown and esoteric subject that emerged in 1940s has now reached a stage of visibility and recognition. The book under review is a critique of this journey in terms of its foundations, methodology, contributions vis-à-vis conventional economics and its practice related to Islamic banking and finance. The author has been a fellow traveler on this journey. In a way, it is a stock taking from an insider's perspective, a narrative that is woven around disillusionment. The book is a provocative contribution to the literature. He has raised a large number of issues and concerns that are not possible to encompass here. However, a representative sample is reproduced for review.

The book contains four parts, consisting of twenty two chapters. The first part is devoted to Islamic economics. Part II is related to prohibition of *ribā* and part III focuses on Islamic banking and finance. The fourth part deals with *zakāh*.

In the first part devoted to Islamic economics, the book discusses its evolution and achievements. He writes that most of the literature developed cannot be genuinely called 'economics'. It "consists mostly of theology on economic matters" (p.7). He says that "the direction of research in Islamic economics has shifted away from Islamic Economics to Islamic Finance" (p.12). He contends that despite efforts, the

discipline is devoid of theories of prosperity and misery, income and wealth distribution, economic development, macroeconomics etc. (p. 16-20). Moreover, its terminology and phraseology are not standardized, creating fuzziness and imprecision in the discipline. In short, he states that Islamic economics as a discipline has achieved nothing notable. In his words "Islamic economics is rephrasing of conventional economics with a flavor of the Islamic Sharī'ah Peeling off the layers... leave the literature on Islamic economics more or less similar to conventional economics has presented" (p.24).

In chapter 2 entitled "The 'Why' of Islamic Economics" he writes that justification for a separate discipline of Islamic economics is not persuasive. He argues that one of the planks of argument for development of Islamic economics is that it is not value neutral about social and ethical aspects unlike conventional economics. The author contends that this concern is already addressed by conventional economics by inclusion of issues of corporate social responsibility (CSR) and pollution. The selfness assumption of conventional economics and the stance of Islamic economists that it needs modification is also not tenable as economists like Amartya Sen have amplified its definition.

Furthermore, according to the author, the claim of superiority of the Islamic economic system vis-à-vis the capitalist system is also not based on solid arguments. Further, he writes that "Muslim Economist would have to move away from the framework of theology and adopt the framework of social sciences to develop this discipline" (p 39). He produces various definitions of Islamic economics and says consensus is missing about the definition. He argues "How can a discipline advance without the unambiguous definition of the discipline itself". In addition to this, in his view, the scope of Islamic economics is not defined and until this is done, "the subject will remain intermingled with theology, sociology, history..." (p.49).

Regarding the need for a methodology of Islamic economics, he writes that the use of conventional tools of analysis is not wrong. However, he cautions that indiscriminate use of these tools can erode the identity of Islamic economics as a separate discipline. He points out that the quest to catch up with conventional economics has led to erosion in this distinctness. He is of the opinion that the challenge for Islamic economists is to integrate assumptions of Islamic economic postulates with conventional economics principles and present them for empirical verification.

He opines that the laws of the Qur'ān have to be stated to discover the cause-effect relationship. This is needed to expand the frontiers of Islamic economics to set the research agenda. He gives the example of *barakah* and its measurement in this context. He suggests that "A possible method (to measure *barakah*) is to take two enterprises engaged in the production and marketing of similar products. The enterprise should be of similar size in terms of investment and lines of production. The operation base should be the same area. Then, over a period, it should be observed how the two firms perform. The difference in their performance can be attributed to *Baraka*" (p.92-93).

Evaluating Muslim thought on interest, he writes that it has gone through evolution. The orthodox position is that all types of interest rates are *ribā* and thus unlawful. He says that some modernists argue that only usurious rates and

interest on consumption loans for the poor are *ribā*. He points out that with the development of Islamic financial institutions, many scholars have accommodated interest in one guise or other. In this regard, according to him, the most significant concession is the permission to charge a higher price for a good if sold on credit as compared to its cash price. He writes that Muslim practice has moved in the right direction except that the orthodox position that treats all form of interest as *ribā*. He makes a distinction between *ribā* and interest and says that consumption loans can be described as *ribā* but not production loans.

In order to buttress his argument about the distinction between *ribā* and interest in particular and interest in general, he asserts that the Qur'ānic prohibition of interest on loans is a moral restriction and is not a public law (p.33). However, orthodox Muslim scholars argue that the prohibition of *ribā* is a legal offence. He thinks that it is an overzealous interpretation as the Prophet (pbuh) did not promulgate any law on interest as neither the Qur'ān nor the Prophet (pbuh) nor the treasure of Islamic jurisprudence has announced any punishment as in the case of theft, adultery or murder (p.134).

In chapter 14 entitled "Unresolved issues on the orthodox interpretation of *ribā*" he lists issues such as difference in cash and credit prices for the same commodity, discounting of receivables, the time value of money, indexation of loans, penalties for delays in the repayment of loans, forwards, futures and options trading and other issues such as exchange of currencies. For instance, he rebuts every argument put forward to justify credit sale and not justify debt finance. He mounts a trenchant attack on established position of scholars on these issues. In chapter 16 captioned "Prohibition of *ribā*: the way forward", he reiterates his opinion about *ribā* and writes that the meaning of *ribā* was wrongly interpreted and commercial loans are included.

In chapter 17 of Part III dealing with the theoretical basis of Islamic banking, he surveys Islamic banking models and discusses securitization, housing finance, credit cards, managing the supply of money in the absence of an interest rate, and risks in Islamic finance. It also discusses issues in Islamic

banking theory especially stability, question of collateral, deposit insurance, use of LIBOR based returns and Islamic microfinance. Writing about securitization, he states that “the whole deal is different from conventional finance in form and formalities rather than substance. It is even more expensive”. Regarding Islamic housing finance models, he writes that the cost of Islamic finance is high that is why it has failed to gain popularity. On the stability of Islamic banking, he argues that the contention that Islamic financial system will be more stable than conventional financial system lacks empirical support.

Legal stratagem (*hīlah*, plural *hiyāl*) have been an issue and it has been flagged by many Islamic economists and scholars. The author has written a chapter on *hiyāl* listing and discusses some of the *hiyāl* developed by Islamic financial institutions in the realm of *murābahah*, *ṣukūk*, *ijārah*, *salam*, *istiṣnā'* and housing finance. According to him, most of these may have form but are not different from conventional ones. In a separate chapter on *takāful* he echoes the same. This is wrapping up of conventional insurance with the blessing of Sharī'ah boards. He writes that “Muslim scholars are gradually conceding ground to conventional finance for various types of transactions” (p.393). The trend calls into question the “rationale for devising Islamic financial institutions and instruments in the first place”. He sums his argument by stating that the entire venture to create Islamic financial institutions without interest is a “Rejoicing in a framework of hypocrisy that entails higher costs, bigger risks and greater inefficiency” (p.399).

In the part on *zakāh*, he writes that the orthodox position on matters such as rates, exemption limits (*niṣāb*) and expenditure heads of the *zakāh* needs reinterpretation and re-examination in a present day context. He opines that the progress in this direction is hampered by treating *zakāh* as a devotional practice (*'ibādah*) leading to its implementation in letter not in spirit. According to him, this problem can be surmounted if *zakāh* is classified as transactional law, not devotional law (p 417). He, further in this context, mentions that the traditions of the Prophet (pbuh) has a temporal context and a “blind application of the traditions

can defeat the objectives of the Sharī'ah itself” (p 417). In support of his argument, he cites that the changing complexion of the business such as leasing, financial services, consultancy, media and so on do not have any stock-in-trade in the traditional sense. Applying traditional principles will leave a large number of wealthy people outside the ambit of *zakāh*, he contends.

The sample of issues and concerns provided above require rigorous academic response. However, I will confine myself to a few of these issues. To begin with, his view that the development of a discipline is dependent on consensus about its definition and scope is not sound. The definition of economics in conventional literature mostly revolves around the scarcity principle. However, still this definition is in a flux. Colander (2013) defines “Economics is the study of how human beings coordinate their wants and desires, given the decision-making mechanisms, social customs, and political realities of the society” (p.4).The twenty principles of economics listed in the bestselling book of Mankiw, still are not settled. Colander (2016) has modified it and provided a more nuanced principles. Nobel Prize winning economist Thomas Sargent, while delivering a speech in 2007 at UC, Berkeley, narrated twelve postulates of economics that he thought were not controversial, but Paul Krugman dissented. Even signature assumption of economics that ‘there is a tradeoff between equality and efficiency’ was contested.

Further, to limit the scope of economics to so-called puritan and unadulterated economics is to ignore the recent move toward cross-disciplinary and interdisciplinary work including Insights from disciplines such as psychology, sociology, and neuroscience. These developments have greatly enriched our understanding. For instance, the new field of Behavioral Economics draws from psychology, sociology, and neuroscience and challenges the benchmark assumption of rationality among other things. Dani Rodrik (2015) writes, “Economics provides many of the stepping-stones and analytic tools to address the big public issues of our time. What it doesn’t provide is definitive, universal answers. Results taken from economics proper must be combined with values, judgments, and evaluations

of an ethical, political, or practical nature. These last have very little to do with the discipline of economics, but everything to do with reality" (p.86).

Akram Khan writes that the discipline of Islamic economics has to liberate itself from theology to attain development. Economists pretend to be value-neutral but all economists bring elements of ethical consideration into their analysis. It will be apt to point out that religion is the oldest and the most influential institution in the world and religious norms greatly influence human behavior. George Akerlof writes in this context that economic theory is devoid of this element. He writes that "Norms are particularly clear when people hold an ideal of who they should be and how they should act. (By ideal we mean the exemplary characteristics and behavior associated with a social category.) This ideal may be embodied by a real or imagined person. Religions offer obvious and powerful examples" (p.11). Therefore, even theology may aid in our understanding of human behavior or in shaping it. In recent times, the tools of Behavioral Economics are used in altering human behavior in a positive way through 'nudges'. According to Thaler and Sustein (2008) a nudge is – a deliberate design of the choice architecture that alters people's behavior in predictably positive ways.

To say that economics is no longer value neutral is unfounded. Amartya Sen cannot be invoked to support one's argument. Still the leading textbooks of economics present concepts and postulates of economics as value neutral. To say that CSR has become part of economic theory is not true. Regarding the lack of economic theory on income inequality, it may be pertinent to note that even the conventional economics till recently was without a cogent theory. The topic has occupied center stage following the publication of Thomas Picketty's book *Capital in the twenty-first Century* (2014).

Akram Khan writes that economic principles derived from the law of the Qur'an should be cast as a cause-effect framework. All the economic principles from relationship cannot be presented as cause and effect phenomena. Causation is different from association (Correlation). Dani Rodrik (2015) writes that "All the valuable lessons that the beautiful profession teaches are contextual. They are if-then

statements in which the "if" matters as much as the "then" (p.63). The methodology suggested by Akram Khan to measure the unmeasurable (*barakah*) is naive. One important issue, especially in the finance industry, is attribution of performance of fund managers; whether it is engendered by the skills of the manager or was the result of luck. Unfortunately, no clean test is available to disentangle luck from skill. How one can measure the unmeasurable "*barakah*" is an open question.

The problem with his critique is that he brings into question the fundamental tenets of Islam such as the prohibition of *ribā*, abandonment of which will bring down the entire edifice of Islamic economics. He, throughout the book, advocates that a distinction be made between *ribā* and usury. He states that since no punishment has been described for *ribā*, it should not be elevated to something abhorrent. It may be noted that the law framed by any society is an attempt to codify notion of right and wrong, just and unjust, approved and unapproved behavior. *Ribā* is considered unjust and it is to be eschewed. Even in western society, usury law prevails. Going by his argument, no law should be framed. If debt is considered risky, the regulatory authority may prescribe capital adequacy norms as is done.

In some cases, he questions well-established findings. In the wake of the financial crisis, almost all studies pointed out that debt was the main culprit. He cites sparse empirical findings related to Islamic banks as a limiting factor to draw any conclusion regarding stability of the financial system that it is supposed to bring about. It defies understanding whether this will modify findings about the pernicious effects of debt on the financial system. At a time when new and fresh arguments against debt are appearing it will be imprudent to embrace the path of the conventional banking system. The role of debt as precipitator of crisis has attained almost universal acceptability. Atif and Sufi (2014) write, "Taken together, both the international and U.S. evidence reveals a strong pattern: Economic disasters are almost always preceded by a large increase in household debt. In fact, the correlation is so robust that it is as close to an empirical law as it gets in macroeconomics" (p.9). Turner (2016) states that "The dangers of excessive and harmful debt creation

are inherent to the nature of debt contracts. But they are hugely magnified by the existence of banks, and by the predominance of particular categories of lending". He writes that economics or finance textbooks describe "How banks take money from savers and lend it to business borrowers, allocating money among alternative capital investment projects. But as a description of what banks do in modern economies, this is dangerously fictitious..... because the vast majority of bank lending in advanced economies does not support new business investment but instead funds either increased consumption or the purchase of already existing assets, in particular real estate and the urban land on which it sits" (p.6). He states further that "This result in a growth of debt that, contrary to the textbook assumption, does not support productive capital investment and does not therefore generate new income streams with which debt can be repaid causing severe economic harm" (p.6). Concerning the efficiency issue of banks, Admati and Martin (2013) write, "The key objective of banking regulation must be to guard the safety and soundness of the financial system in the public interest. Other concerns should not interfere. Promoting the competitive success of banks in the global markets is not in the public interest if this success is due to banks taking excessive risks at the expense of taxpayers. Many countries have paid dearly for the successes of their banks" (p.94). The relative inefficiency of Islamic banks (if any) is preferable over stability. Paul Samuelsson once made a remark, "Every good cause is worth some inefficiency". The recent financial crisis has highlighted this fact. What is the use of such efficiency, if it contains seeds of destruction? Turner (2016) writes, "If debt can be a form of economic pollution, a more complicated and sophisticated debt creation engine can make the pollution worse" (p.6).

Akram Khan's call for a review of the orthodox position on *ribā* has no cogent academic argument,

leave aside, a religious mandate. He says that consumption loans can be described as *ribā* but not production loans. The loan profile of modern commercial banks, if anything to go by, is loaded in favor of consumption loans as pointed out by Turner (2016) (quoted above). Thus, the practice of conventional commercial banks will fall under the rubric of *ribā*. It is ironic that he is advocating a banking system that promotes unproductive activities, is exploitative and makes the economy unsafe.

Not all his critique is wrong, the practice of *hiyal*, form vs. substance issues, needs reappraisal. The shift in focus of the discipline from Islamic economics to a subset (Islamic finance) is also true. However, the book is dominated by selective pickings of pros and cons. He stirs even the issues on which almost a consensus exists. It seems that in order to highlight chinks in the discipline, he lost his way and his noble intentions have turned into a defeatist mindset.

As far as success or failure of the discipline of Islamic economics is concerned, the jury is still out on the question whether it is a failure of ideas or execution. However, in any assessment no matter how uncharitable it might be, the contribution of the discipline in highlighting debt and its harmful effects on the financial system cannot be glossed over. The same conclusion has been reached by the plethora of studies conducted in the aftermath of the recent financial crisis. This has not only led to a convergence of opinions pertaining to debt, but also in the objectives of conventional and Islamic finance i.e. to achieve maximum risk-sharing in the economy (Askari et. al., 2010). To jettison this venture at this juncture, and adopt conventional modes of finance on the grounds that in practice Islamic banking is no different, would be tantamount to throwing the baby out with bath water. Let us not forget what Thomas Jefferson said, "I believe that banking institutions are more dangerous to our liberties than standing armies".

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