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Islamic Economics: Where From, Where To?

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Abstract. One of the fundamental questions in Islamic economics is: how to handle the gap between the desired behavior of economic agents, as read in texts of Qur'ān and Sunnah, and that observed in current reality? Early writers paid little attention to this question. Their references to Islamic history were largely confined to the earliest period in the Arabian Peninsula, little attention was paid to other regions and later times. The author argues in favor of policies derived on the basis of objectives of Sharīʿah rather than those in *fiqh* derived analogically from early rulings. Future shape of things deserves more attention, innovation and creativity may answer vexed questions. The role of debts needs to be drastically reduced, and that of participation encouraged in finance and management of money. The focus should be the humanity as a whole; welfare of the Muslim Ummah should be targeted within that framework.

Key Words: Islamic economic paradigm, Role of *fiqh* in Islamic economic theory, *Maqāṣid al-*Sharīʿah and practice of Islamic finance.

KAUJIE Classification: B3, B4, H12.

The Beginnings

This is a personal review of the development of Islamic economics paradigm as it stands today, in the perspective of its beginnings about seven decades ago. Revisiting my vision of the sixties, I see many ingredients of a vigorous recipe missing. First, there was hardly any reference to the then ground situation. The gap between how economic agents: consumers, producers, investors etc., were actually behaving and the way texts from the Qur'ān and Sunnah quoted in my works wanted them to behave, was quite wide. But there was little discussion of why it was so, or how the gap could be bridged and how intermediate states of the world (those between the ideal and the real) could be handled. If the assumption was that it was a matter of will-power/conviction, it was never argued out. No one asked the obvious question: how to create a will strong enough to transform weak preferences into strong motives?

Second, the clearest and loudest part of the clamor was *fiqh* rules like those against monopoly (*iḥtikār*) and for profit-sharing in joint ventures, but the problematic task of transmitting centuries-old rules to a modern rule book was not addressed. Third, in so far as historical instances were cited in favor of altruistic or socially responsible behavior they tended to belong to select periods of Islam's long history, and that too of a particular region. There was a clear tendency to overestimate the power of good intentions and to ignore the tenacity of material interests. The end result has been unrealistic utopias rather than workable agendas.

I pause here to narrate an experience belonging to the 1990s. By then I had become aware of such shortcomings and wanted to rectify the situation. To a would-be Ph.D. student in Ummul Qura University, Makkah al-Mukarramah, I suggested a subject involving some field work besides some textual studies: evolution of the concept of *isrāf* over the ages and across regions. In accordance with the established practice in modern universities, I wanted the student to do some field work in his city of residence by getting questionnaires filled by members of different income groups. But the proposal was turned down by the *fiqh* scholar supervising the thesis. Apparently *fiqh* scholars are not willing to face the reality that the answer to what is *isrāf* will differ as the temporal, geographical and other material conditions differ. Our jurists refuse to acknowledge the context-specific nature of their interpretations of many Islamic norms of behavior. This refusal leads to confusion relating to what is amenable to regulation and what is left to individual discretion.

Lately many economists have focused on the role of information and how asymmetric information affects the principal-agent relationship. The issue is central to a moral economy, but we did not pay attention to it.

Another significant deficiency in the Islamic economic paradigm as conceived by its founders was its being divorced from the sociology of the populations into which the discipline was being introduced. No people, among them Muslims, are mere summations of individuals free to choose and act rationally. Everyone operates as part of an intricate web of relations, traditions, obligations and emotions. People live and act as members of families, tribes, interest-groups, races, etc. Unfortunately, we were not sensitive to this truth, neither in our readings of early Islamic history from which we drew inspiration nor in our understanding of our own peoples, times and places.

Lastly, following the practice in economics, we focused our attention on the market. We tried to elaborate the functioning of the market when economic agents operating there were influenced by Islamic teachings. There is abundant material on the moral economy of Islam in Ḥadīth and Sunnah literature. By hindsight, I now feel it would have been better to start with the family where man first appears and interacts with others. Unlike the cold rationality of the market as conceived by the economists, the family is characterized by caring, gift relationships and altruism before reciprocity exchange and contracts take over. Family relations are personal, full of warmth and mostly sincere. Could a more humane yet realistic model of the economy be built starting from the family? Besides being more in tune with early Muslim economic thinking, research along this line would provide an antidote to the commoditization of family relationships currently in progress.

Current Practice of Islamic Finance

Each and every contract currently used by financial institutions is certified by a Sharīʿah scholar, often a team of scholars. Barring a few bizarre speculative products like debt default swaps, every product currently available in the financial markets is also available, or can be easily made available, in the Islamic financial market. Islamic finance as currently practiced is claimed to be Sharīʿah-compliant. However, there is a growing body of Muslim public opinion that is dissatisfied and refuses to recognize the whole exercise as Islamic. Most of the skeptics refer to the goals Islam seeks in economic life and argue that these goals, like universal need fulfillment and reduction of inequality, are not being served under the current dispensation of Islamic finance. Moreover, the well-documented ills of conventional finance are present in 'Sharīʿah-compliant' finance also. It is not inclusive, bypassing the majority of the populations in the areas it is operating. It helps moving wealth upwards, towards the top of the pyramid, like conventional finance, and it is barely contributing towards the development of Muslim countries and communities.

The anomaly of something conforming to rules failing to realize the goals (for which the rules were supposedly set) is not something new in Islamic legal development. A look at Imam Malik's approach to *maṣlaḥah* (good cause) or Imam Abu Ḥanīfa's concept of *istiḥsān* (preferring the better option) tells us that it takes more than following a set of rules to realize the objectives of Sharīʿah. The ground reality too does not support the claim that following rules always ensures the realization of *maqāṣid al Sharīʿah.* The goals are God-given while the rules are man-made. As a matter of fact the founders of Islamic economics, writing in the mid-twentieth century, emphasized goals not *fiqh* rules. As elaborated in the Qur'ān, Allah will be pleased by men and women who strive to attain a certain state of the world. This state of the world is characterized, among other things, by universal need-fulfillment, human dignity with basic freedoms for all and a distribution of income and wealth that maintains a balance between rich and poor by keeping inequality in check. Its hallmark is justice and equity and elimination of corruption and oppression while ensuring sustainability. The task for model builders is to align incentives with desired behaviors. I sympathize with the perception of common Muslims that the monetary management and financial arrangements in Islamic set-up should serve these goals.

The disjunction between Islamic and conventional capitalistic finance is not trivial. The current system of money, banking and finance is based on debts, and debts carry interest. As the real economy of goods and services is not growing at a faster rate, due to long-term environmental constraints and short-term resource constraints, outputs need not always exceed the inputs by the amount of interest due on the capital invested. Debt defaults are endemic. Under debt-financing money lent sucks in more money, leaving the real economy starved of resources and results in unemployment. As profit-making productive opportunities shrink; profit seekers turn to rent seeking (i.e., snatching away wealth already created from the one who owns it as distinct from producing new wealth). Society's God-given resources meant to support life for all (Your property that God has made means of your sustenance (Qur'ān, 4:5), become concentrated in the hands of a few. Increasing inequality in the distribution of income and wealth is accompanied by instability.

Availability of debt papers in large quantities creates a market that provides abundant opportunities for gambling-like speculation. In Islamic financial markets trading in debts, followed the entry of 'trade-based' modes of finance especially the widely popular *murābaḥah*. The move was ingrained in the hasty manner in which the rulers introduced Islamic banking in Pakistan.

Scholars' attention has largely been focused on freeing the system from *ribā*/interest. Little attention has been paid to how money is created and managed. The case against using debt as a financial instrument cannot be appreciated without bringing in the role of debt in monetary management. Modern money is almost all debt. Money is created (printed) at the central bank level and injected into the economy in exchange for bonds issued by corporations (and/or bonds issued earlier by government and kept by banks, businesses and individuals at home or abroad).This 'high-powered money' enables the commercial banks to issue more money as debts owed to them. All money in circulation is debt owed to someone to whom interest must be paid. The only exceptions are demand deposits on which banks do not pay interest to depositors. Overtime money must grow for the interest due to be paid. Since mere passage of time is no guaranty for growth to take place, and not all money is used for productive purposes, default is built into the system. Historically, the situation has been resolved in one of the three ways. Firstly, a certain kind of debt is based on the condition that the principal is never to be repaid, the bond holder being entitled to annual interest payments in perpetuity. Secondly, a creeping inflation lightens the burden on debtors, enabling them to pay back in money having weaker purchasing power. Lastly, bankruptcy laws are designed with the purpose of writing off some outstanding debts to enable the borrower to make a fresh start. But these solutions are no good for the state as a borrower. Firstly, as states borrow from public to fill budgetary gaps, their indebtedness goes on increasing. Secondly, there could be no bankruptcy laws to relieve the states that are often obliged to borrow abroad in foreign currencies. Lastly, inflation that works to the advantage of private debtors works to the disadvantage of indebted states whose currency falls in the foreign exchange market.

The Audience

The pioneers addressed the humanity as a whole, challenging their perceived competitors: Capitalism and Socialism/Communism, which were attracting Muslim youth. Bulk of the literature in Islamic economics in the beginning is universal in its appeal, paying little attention to the nitty-gritty of applying the proposed models to a particular country or community. Could profit-sharing modes of financial intermediation flourish in environments low in trust and lacking appropriate legal framework? Such questions were neither raised nor answered in books like Baqir al Sadr's "*al- Bank al la Rabwi fil Islam*" or this author's "*Banking without Interest*."

Those who proposed debt-creating models later on failed to see that debt-finance would lead them straight into the capitalist financial markets. Their assumption that a ban on sale of debts would prevent proliferation of debts proved wrong. Debts for sale entered Islamic financial markets as minority components in bundles of *ṣukūk*, a process endorsed and practiced by Islamic Development Bank, Jeddah.

The country-specific legislations that came up in 1980s aimed more at scoring political points and acclaim from the masses than responding the ground realities in the poverty-stricken regions of Pakistan, Iran or Sudan. This is further evidenced by the top-down approach adopted with little input from the entrepreneurial classes and from those dealing with society's monies, their transfers and uses. With the bulk of populations in these countries too poor to attract bankers' attention, the first phase of Islamic finance failed to include microfinance or cooperatives. Did they, microfinance societies and cooperatives, seem irrelevant in the grand debates on Islam versus Capitalism/Socialism?

More than a third of the world population of Muslims lives in countries whose majority is not Muslim. In most of these countries, especially in India, small enterprises and self-employment is the mainstay of the Muslim economics. Financing these communities has special problems that large-scale commercial banks are not able to handle. Cooperatives and microfinance institutions are designed to serve these sections of the population. Islamic finance has been slow to realize this, and there is little action even now. Many small but prosperous Muslim communities on the Malabar Coast in India, Yemen, Zanzibar, and other parts of South Africa and around the Malacca strait in South East Asia have been successfully practicing participatory finance for centuries(1). Trust and tradition form the basis of credit and cooperation in these communities. There has been little realization back in the 1960s and even now, in the second decade of the twenty-first century, that Islamic finance could learn from these grass-root institutions. Financial

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(1) **Goitein** (1968).

intermediation through commercial banks needs not be the only choice for Islamic finance.

Over the years I have come across many well-meaning persons, among them Sharīʿah scholars, who do not believe in financial intermediation. They want Islamic banks to do profitable businesses and share the profits with the depositors. This is not a good idea. It has already lost credibility after some Islamic banks, among them the Kuwait Finance House, sustained heavy losses in the real estate market.

Interest in Islamic economics inspired many initiatives of mobilizing *zakāh* and reinvigorating *awqāf*, especially in the Muslim minority countries. But these fields remain the preserve of social activists. Trained economists and Muslim social scientists paid little attention. Their potential role in global Muslim regeneration remains unrealized due to lack of adequate data and workable models based on proper analysis. Unfortunately, long-term researches needing heavy investment have yet to find sponsors.

Maqāṣid versus Logic

In launching the Islamic economics initiative the writers in mid-twentieth century were largely inspired by texts in the Qur'ān and Sunnah emphasizing *tawheed* (oneness of God), human brotherhood, cooperation, sharing of God-given resources, etc. They also looked to the years under the rule of the Prophet, (PBUH), and the pious caliphs and drew inspiration from selected periods of Islamic history. Their references to *fiqh* were rare. As the Islamic financial industry expanded and the Islamic financial institutions felt obliged to rely on *fatāwá* to gain credibility in Muslim masses, *fiqh* became the mainstay of emerging Islamic economics discipline as well as the Islamic financial industry. Unfortunately, *fiqh* as practiced lately lacked the creativity that characterized it in its formative periods. It had since long abandoned its resolve to translate Islam's cherished goals in socio-economic affairs into operable norms of behavior, rules of conduct and guidelines for public policy in changing circumstances. Despite century-long efforts to restore *fiqh* to its original vitality, its modern practitioners failed to guide Islamic banking and finance towards establishment of a just, equitable and efficient economic society. Even after four decades of practice, the regions claiming lion's share of the market for Islamic finance, the Gulf area and South East Asia, retain gross inequities and low levels of efficiency.

A greater recourse to history would have given us an idea of how and to what extent Muslims in various regions of the world were able to realize the Islamic economic goals. Even the instances of poor performance would have lessons to learn from. But just as ignoring sociology, neglect of history has deprived Islamic economics initiative of the realism, gradualism and flexibility needed to forge ahead while protecting its identity and serving its goals. The *fiqh*-based strategy of emulating conventional finance threatens to deprive it of both.

Those who dumped the history to the dustbin once *fiqh* was considered to have been finalized by about the end of fourth/tenth century did so under a false assumption. The mission of Law (*fiqh*) is to capture the divine will (what would please the Lord, *raza-i-ilahi*). No doubt the great Imams did so in a superb way harnessing reason (*aql*), texts of the Qur'ān and Sunnah, and public good (*maṣlaḥah*). But as the time moved on, not only our reasoning but our understanding of the Texts, and our perception of *maṣlaḥah* also changed.

In order to revitalize *fiqh* and reinvigorate the Islamic community, it is necessary to approach all sources afresh. There is a great role *fiqh* is destined to play in our efforts to create a modern Islamic society. But the way to do so is not to treat *fiqh* as a body of rules valid for all times and places but a context-bound exercise of capturing God's will. This requires analogical reasoning (*qiyās*) being given a second place after taking into consideration private benefits (*manāfiʿ*, public good (*maṣlaḥah*), social consequences (*maʿālāt*) and the other objectives of Islam (*maqāṣid*). Micro- and macro-economic analyses, sociological and psychological studies and impact on the environment are better guides for reaching the right decisions under new conditions than logic and old precedents.

It takes time. Meanwhile, analogy-focused *fiqh* must be supplemented by a heavy dose of history. *Fiqh* rulings of the great Imams and those cherished by different schools of *fiqh* need to be reported along with full disclosure of when where and under what socio-political circumstances the rulings were given. As regards finance, the evolution through history and across regions of various practices like *qarḍ ḥasan*, trade credit, *ʿurbūn*, *ṣukūk*, etc., need to be studied with a view to understanding how Muslims guided by their *fiqh* advisers met the changing needs of business. The same needs to be done with respect to *zakāh* administration, insofar as *zakāh* is an economic institution as well as an act of worship like prayers. Its coverage and uses have been evolving since the earliest times and need to continue doing so. *Awqāf*, the mainstay of welfare services in the Muslim past also deserve in-depth studies. The more detailed and clearer picture we have of how Muslims tried to establish God's will in changing circumstances in economic affairs, in different times and places, the more our current economic thinking will be on the mark. Unfortunately, it has not been so in the past.

Identity

Our greatest asset is our distinct identity. That can sustain norms of behavior of an Islamic society characterized by balance and equity. The greatest loss during the last two decades has been an erosion of identity and assimilation into conventional finance. The future of Islamic economics and finance depends on how it responds to the coming changes in technology and psychology.

It has always been problematic to predict the future, but the current pace of change makes it almost impossible to do so. From the economic point of view big changes may occur in money, monetary management and industrial organization. With the decline of nation-states, private initiatives in production and exchange of wealth may gain strength and their amenability to control and regulation may weaken. Financial options may increase with direct finance supplanting financial intermediation. Some are also talking of economics of abundance, rendering abject poverty a thing of the past. But plentiful resources do not guarantee equitable distribution. Increasing inequality leading to a feeling of indignity and marginalization of the people at the bottom of the pyramid is a source of instability and strife. It is a case of moral failure rather than of market failure. Scarcity or abundance has little to do with moral failure. Divinely inspired morality rooted in spirituality and a sense of a universal mission has been an essential feature of the Islamic movement that outpoured into Islamic economics. Losing that sense may cause a collapse of the move towards an Islamic economy.

Whether a single world currency will materialize is a doubtful proposition, but the disappearance of physical money seems to be a possibility. Physical money as we know it now may dissolve into bits and bytes, barter and reciprocal gift relations may re-surface, and novel financial arrangements may replace banking as practiced at present. Islam is open to innovations. It never tagged its destiny to any particular arrangements, focusing as it does on fairness.

Threats to mankind from outside, ecological and environmental threats are likely to enforce greater cooperation between peoples. Nation states may well yield to more cosmopolitan arrangements. This will be advantageous to the Ummah of Islam, which has never been at ease with nation states.

Islamic economics initiative promises to build an economy on freedom, enterprise and compassion. For a world sick of increasing inequality, of development for few and anxiety for all, exposed to dangers from within and without, these promises matter. What is missing is something to make them credible. Creative thinking for making moral values operational and innovating ways to serve the common good may bring the needed credibility. The information deficit standing in the way of a moral economy is not as in-surmountable a hurdle as it seems to be. Islam provides the philosophical framework for the cooperation needed to fill the information deficit and face the uncertainties embedded in the human situation.

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