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Islamic Economics: Where From, Where To? (Muhammad Nejatullah Siddiqi)

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It is important to acknowledge earlier shortcomings in any branch of academic enquiry with hindsight, even though for many, self-criticism of one's own earlier work is often difficult. In this context it is refreshing to read Nejatullah Siddiqi, a leading pioneer of Islamic economic thought over half a century ago, freely admit the limitations of his earlier writings. Constructing a convincing Islamic economic paradigm has proved, in Siddiqi's view, a much more difficult task than the early pioneers envisaged, not least given the enormous gap which exists between the desired behavior of economic agents as delineated in the Qur'ān and Sunnah and the reality of morally dubious decision-making and self-serving economic governance at all levels. Siddiqi's revised observations are well argued and convincing. They provide a base line for the "where to" debate about the future for Islamic economics, and indeed whether it has a future given the resilience of global capitalism despite the financial crisis of 2008 (Ahmed, Habib, et.al, 2014).

Islamic banking realism

Much of Siddiqui's paper is devoted to the incompatibility of the capitalist financial system with Islamic teaching and the shortcomings of Islamic banks as currently structured. The criticism of Islamic banks is not new, and is present in Siddiqi's previous writing, but many in the Islamic financial services industry will argue that it is unfair and unjustified. Islamic banks have been successful precisely because they can provide a similar range of financial services to their conventional competitors, which is what their customers want[(1)]. Crucially they provide such services in a Sharīʿah-compliant manner, their distinction being in how they provide the services, not in who are their depositors and how the financing is allocated.

(1) Islamic banking assets exceeded $1.4 trillion at the end of 2013 with Malaysia accounting for $125 billion, Saudi Arabia $107 billion, UAE $85 billion and Kuwait $70 billion. See KFH Research, *Islamic Finance Outlook 2014,* pp. 12-16.

There is little point in arguing that Islamic banks should focus on activities such as micro-finance when most clients in the major markets where Islamic banks are most developed, such as the GCC states and Malaysia, are middle class and far from being poor. What customers want and receive are retail banking services such as current accounts to manage everyday personal transactions and vehicle and housing finance. They are also offered investment accounts which enable depositors to share in the bank's profits, but downside risks are necessarily limited, as it would be unfair to encourage families of modest means to take excessive risks with their savings. The very affluent can afford to take greater risks in order to attain higher returns, but the Muslim middle classes are justifiably cautious. Risk sharing is a key feature of Islamic finance, but those who take on risk must have the resources to cope in worst case scenarios.

The role of money

Siddiqi discusses briefly the role of money in an economy, stressing that the focus of *fiqh* scholars has been on freeing the system from interest, but with little attention being given to how money is created and managed. There is much confusion in recent Islamic economics writing on the role of money, and the shortcomings of the academic literature in this area are reflected in the absence of any viable alternative to conventional monetary policy anywhere (Choudhury, 1997). Siddiqi is correct in equating all money with debt, but incorrect in asserting that demand deposits are any different, as they are bank liabilities or in other words bank debts to their customers. Current accounts with Islamic banks admittedly pay no interest, but they are still bank debts. They can be classified as narrow money. The broad definition of money includes savings accounts, sometimes referred to as near money if, as is often the case, they are subject to periods of notice for withdrawals. In practice investment accounts with Islamic banks also constitute near money, but this is little discussed in the Islamic economics literature.

Money transmission mechanisms are also largely neglected by Islamic economics writers. As with conventional bank financing, Islamic banks provide customer financing through current accounts, notably with *tawarruq,* which adds to the money supply in the short term, but is largely neutral when the financing is repaid from the client's current account. As an Islamic bank is the purchaser with *murābaḥah* and *ijārah* financing, the money often goes directly to the supplier's bank account rather than to the client's account, but repayments come from the client. Again the effect of such financing may be broadly neutral as far as the money supply is concerned, although if the supplier is in another country, as is often the case, then the money supply of that country will be increased, but there may be a deflationary effect in the country where the Islamic bank and its client are located. These issues have yet to be explored in the Islamic economics literature, but the effects are similar to those with conventional trade finance.

Siddiqi discusses high powered money which is created when central banks purchase government bonds reducing the cost of state funding. Excessive creation of high powered money can add to inflationary pressures, which is countered by 'tapering', the policy of the United States Federal Reserve to unwind its bond buying program as economic growth resumes. Tapering has had the unintended consequences of raising interest rates in emerging markets, including those of Muslim majority countries such as Turkey and Indonesia. Despite the profound significance of these trends, there has been no analysis of the effects by Islamic economists. There is clearly much wrong with the *ribā*-based international financial system as the global financial crisis of 2008 revealed, but a more insightful critique by Islamic economists is needed as circumstances change.

Cultural and social factors

Siddiqi correctly argues that the advocates of Islamic economics focused on comparative economic systems, contrasting the inherent justice in an Islamic system with the perceived injustices of capitalism and communism (Tripp, 2006). However the cultural, social and political contexts were largely ignored. Siddiqi questions whether profit sharing methods of finance can flourish in environments where there is little trust and the lack of an appropriate legal framework. Unfortunately this is the reality in many Muslim majority countries (Kuran, 1995)).

Initiatives to promote Islamic finance usually came from governments in Muslim countries, the aim being to demonstrate their Islamic credentials, and score points over other governments (Behdad, 1994). This top-down approach is criticized by Siddiqi, who believes that a grassroots populous approach will be more fruitful and sustainable. Siddiqi believes more historical studies are needed of local Islamic finance initiatives through co-operatives as in India, Yemen and parts of Africa. Documenting such studies and drawing on the lessons is likely to be a major challenge. Nevertheless examining detailed case studies of Islamic finance initiatives has much merit, by demonstrating the wide range of possibilities which such financing opens up.

Whither Islamic Economics?

Siddiqi has high goals for an Islamic economy which he sees as based on freedom, enterprise and compassion. He calls for creative thinking to make moral values operational, and innovation to ensure an Islamic economy serves the common good. Siddiqi has a vision of the big picture, but leaves it for others to work out the detail. The detail is however crucial, and a major failure of academic writing in Islamic economics has been its inability to address the issues of public policy choices (Proyer, 1985). This has left governments who favor an Islamist agenda without a coherent set of economic policies to tackle major issues such as youth unemployment and reallocation of funding from wasteful subsidies to promote sustainable development. An Islamic fiscal policy is not simply about adding *zakāh* to policy agenda and establishing more *waqf* endowments, but rather about discussing how great a role government should play in an economy and examining the merits of direct and indirect taxation.

Contributors to the Islamic economic literature inevitably have diverse views on the role of the government in an economy and the size of the state in relation to private sector. Some favor progressive income tax with higher rates for those with greater salaries and exemptions for the low paid. The scope of indirect taxes such as value added tax needs more consideration. Should food and children's clothing be exempt from such taxes with the main burden falling on consumer durables and household goods? In countries where non-Muslims resist prohibitions on alcohol, is it desirable to levy additional taxes on such *ḥarām* products? Should 'sin' taxes include substantial excise duties on tobacco? Other issues include employer and employee contributions to social security to cover illness and pensions? Compulsory national insurance is desirable, but the contributions raise the cost of employing labor and very high rates can damage employment prospects as businesses become less competitive.

The existing literature on Islamic economics focuses on *maqāṣid,* attaining the goals of the Sharīʿah (Chapra, 2000). Siddiqi highlights the stress on human brotherhood and the sharing of God given resources. These are worthy objectives that can frame research agendas, but the emphasis for the next generation of Islamic economists should not be to try to develop more theory, but rather to focus on economic policy issues (Tag el-Din, 2013). At present there are no countries implementing economic policies that have been based on *maqāṣid*, which remains an ideal rather than a reality. The fault does not rest with governments however, but rather with the failure of academic researchers in Islamic economics to study the policy options confronting modern states. Academics cannot and should not dictate policy, but by examining the merits and drawbacks of different economic choices they can provide valuable advice. Unfortunately at present the Islamic economics literature does not provide any guidance in this respect.

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