

Crisis in Islamic Economics: Diagnosis and Prescriptions*

Asad Zaman

International Institute of Islamic Economics

Islamabad, Pakistan

asadzaman@alum.mit.edu

Abstract. There is substantial evidence that the development of the discipline of Islamic Economics is currently in crisis. In this article we argue that the main reason for this is that most Muslim economists have accepted too many of the ideas of Western economists uncritically. The methodological framework, and underlying assumptions are wrong, and in conflict with Islamic views. This conflict has not been recognized, and the attempt to combine contradictory bodies of knowledge has failed. We also present alternative foundations on which a genuine Islamic economic theory could be constructed.

Keywords: Islamization of Knowledge, Islamic Economics, Economic Methodology.

1. The Islamization of Knowledge

The project of “Islamization of Knowledge” continues to be of vital importance to the Ummah of Muslims. The future of any community is strongly linked to the education received by the children in that community. Today, the vast majority of Muslim children receive a secular Western education. Built into such an education are assumptions that contradict basic Islamic teachings; for example, the separation of state and religion, based on the idea that religion is a private and personal matter, and should not be brought into the public domain. Because of these conflicts, many Muslim intellectuals have argued for the necessity of assimilating Western knowledge into an Islamic framework. At the dawn of the fifteenth century Hijrah, the Organization of Islamic Conference (OIC) created two universities – the International Islamic Universities of Islamabad and Malaysia – for this explicit purpose. All across the Islamic world, a large number of diverse initiatives have been launched for this purpose

* Prepared for 8th International Islamic Economics Conference, Qatar, 25-27 Dec. 2011.

of integrating our traditional corpus of Islamic knowledge with modern Western knowledge.

Because of its vital importance, large amounts of individual and collective efforts of Muslims have gone into achieving this goal. While partial success on certain limited fronts has been achieved, it would be fair to assess the overall outcome as a failure. Many of the leading scholars who have spent their lifetimes on this goal have acknowledged this failure, as we will shortly document. Corresponding to this failure, many diagnoses have been offered as to the reasons for this failure. In this paper, our goal is to provide a new diagnosis of the reason for the failure. A correct diagnosis is essential to providing a proper remedy; existing misdiagnoses have not allowed for application of the correct curatives. To summarize briefly, we will argue that there are strong conflicts between Islamic views on the nature and purpose of human existence and Western views. The full extent of this conflict has not been realized by most who have worked on the Islamization of knowledge project. As a result, they have attempted to integrate two conflicting bodies of knowledge, which is an impossible task. This is what accounts for the failure of these attempts.

To keep the discussion sharply focused, in this paper we confine our attention to ‘Islamic Economics’ or the project of Islamizing the Western discipline of economics. The broad principles underlying social sciences as developed in the West, and their conflict with Islam, has been discussed separately in Zaman (2009) “Origins of Western Social Sciences.”

2. Islamic Economics is in Crisis

There are many signs of failure of the project of coming up with an Islamic alternative to Capitalist Economics. Leading figures in the field of Islamic Economics have expressed disappointment with the current state of affairs

Umer Chapra (2000, p 375) writes: “... Islamic economics has been unable to come to grips with ... the problems faced by Muslim countries.”

Nejatullah Siddiqi (2008) writes that “All is not well with Islamic economic(s) ... The grand idea of providing an alternative to capitalism and socialism ... has yielded to a desire to join the flock.”

Monzer Kahf (n.d.) in “Islamic Economics: What Went Wrong” writes:.

Besides, Islamic economists did not provide any agenda for political economics founded or derived from their branch of human knowledge inspite of the need for such an agenda.

It seems to me that the present generation of Islamic economists is exhausted and already consumed in the activities of Islamic banking and finance that the best it can do is to hand over the torch to a second generation that may carry deeper theoretical analysis and fill the gaps left by our generation.

These are the pioneers of the field, who have invested their lives in its development.

Critics have been much harsher. For example, Sohrab Behdad (1994) talking about attempts to implement Islamic Economics in Iran under Ayatullah Khomeini writes that “It has become apparent that Islamic Economics is not capable of presenting a viable social alternative.”

Similarly, Timur Kuran (1997) writes that “Islamic economics did not emerge from a drive to correct economic imbalances, injustices, or inequalities ... (but to) restore Islamic community’s self-respect. Because Islamic economics was developed to serve cultural and political ends, it did not have to meet scientific standards of coherence, precision, or realism.” In simpler words, Kuran says that Islamic Economics has no substance or content. It is simply a part of an effort to create a differentiated Islamic identity.

There is no textbook of Islamic Economics, despite numerous efforts to create one. The diversity of opinions among Muslim economists is extreme. We do not have any agreement on even the definition of “Islamic Economics,” and no clear model of what an ideal Islamic economic system would look like in concrete and practical terms. Aware of these problems, leading scholars have argued that Islamic Economics is in an embryonic state. They have argued that it has taken centuries for Western economics to achieve its current polished form, and similarly, some time will be required for the development of an Islamic alternative. Such counsel for patience is of course also an admission of current failure. We will argue below that the problem is more fundamental, and current approaches to the development of Islamic Economics are bound to fail. We will try to sketch more promising alternatives.

3. Four Fundamental Flaws in Economic Theories

There are four background assumptions of economic theory as currently presented in textbooks used in Economics departments in USA and Europe. All of these four assumptions are wrong. Because Islamic teachings are in conformity with the realities of human existence, acceptance of these assumptions leads to contradictions which cannot be resolved. The only solution to this problem is to reject conventional economic theories as well as

methodology, and start from the background assumptions furnished by Islam. The object of this section is to define, discuss and refute these background assumptions of modern western economic theories.

3.1 Economic Theories are Universal Laws

It is assumed, without explicit statement, that the best way to study economics is via universal laws of economic behavior, which are invariant in time and space. Thus economic theory is the same in Great Britain in 1800, Argentina in 1900, and Somalia in 2000. More accurately, economists see their discipline as being engaged in studying those features of the economic environment and behavior which are independent of history. This is why some prominent economists were bewildered at being blamed for the failure to predict the global financial crisis of 2008. They thought naively that this historical event has nothing to do with their discipline. Looking through the entire corpus of textbooks in use in orthodox Economics departments in the USA and Europe, we will not find particular historical explanations of economic events. Such explanations, even where available, are not considered part of economic theory, because they cannot be generalized across time and space.

Consider, for an illustrative example, a study of the economy of Germany between the two world wars. Because they lost World War I, a punishment in the form of heavy reparations payments to the victors was imposed on the German economy. Keynes predicted that this injustice would lead Germany to revolt against these terms and lead to another war within twenty years. A modern economist studying the inter-war economy of Germany would create a macro model in which a foreign tax is imposed on the GDP. The methodological mindset of modern economic theory blinds us to most important fact about this economy, which was the resentment and anger of the population against the heavy and unjust economic burden placed upon them. It was this which led to the rise of Hitler and World War II, and drastically changed the economic landscape of the world.

The lack of attention to historical factors led the Nobel Prize winning economist Douglass North to state that: "We live in an uncertain and ever-changing world that is continually evolving in new and novel ways. Standard theories are of little help in this context. Attempting to understand economic, political and social change requires a fundamental recasting of the way we think." By adopting the framework assumptions of modern economic theories, Islamic economists have crippled themselves, accepting the idea that we must not invoke historical explanations for economic events, since these can never have the status of universal laws. However, the Quran uses both particular historical explanations and universal laws. Thus there is no need for Islamic economists to forego this type of explanation as a methodological principle.

3.2 Economic Theories are Best Framed in Mathematical Form

Due to peculiarities of European history which cannot be detailed here (see Kung 1980), science arose in conflict with, and as a rival to, Christianity. This had two important consequences. One was an exaggerated importance attached to science as the sole source of valid knowledge about the world; this has been called the “Deification of Science,” by Olson (1990). The second was the rise to central prominence of Physics as the ideal model for all scientific thought. Since physics is naturally concerned with measurement and quantification, Lord Kelvin was led to proclaim that when you cannot measure, you do not really know what you are talking about, and when you can, you do. The history of this idea of the central importance of measurement, sometimes called the “quantitative imperative,” has been traced by Michell (2003). Furthermore, mathematical models have played a crucial role in key advances in physics. Mirowski (1990) has documented how economic theories have been developed in direct imitation of models borrowed from physics: “neoclassicals did not imitate physics in a ... superficial manner; no, they copied their models mostly term for term, symbol for symbol.” This imitation has created a situation where economic theories are admired more for mathematical elegance, without any regard for practical relevance.

Nobel Prize winning economist Paul Krugman has said that the entire field of economics went astray because it mistook the beauty of the mathematics for truth. A discussion of the state of economics organized by the AEA concluded that “Economics as taught in graduate schools has become increasingly preoccupied with formal technique to the exclusion of studying real-world problems and issues.” Blaug (1998, *Disturbing Currents in Modern Economics*) thinks that modern economics suffers from “formalism” which is the overuse of mathematical models with more attention to rigor than content. We examine below a single case to illustrate the dominance of mathematical reasoning over economic reasoning.

The Arrow-Debreu model of General Equilibrium is extremely well developed mathematically; however, its economic assumptions of complete markets, zero costs of transactions and information, price taking behavior by all agents, etc. are highly unrealistic. Instead of being criticized for its extreme deficiencies on the economic front, Arrow & Debreu went on to receive Nobel Prizes for the mathematical precision of the model. An intellectual grandchild of Arrow-Debreu is the DSGE (Dynamic Stochastic General Equilibrium) model, which has been blamed for the global financial crisis of 2008. The failure of mathematically sophisticated economic theories has become so glaringly obvious that a Congressional Committee was set up to investigate the role of deficient economic theories in the global financial crisis of 2008. In testimony

before this committee, Solow (2008) commented on the extreme lack of realism in the DSGE model: “A thoughtful person, faced with the thought that economic policy was being pursued on this basis (i.e. DSGE models), might reasonably wonder what planet he or she is on.”

It is worth noting that Umar R.A. carried out censuses to determine how to justly and equitably distribute revenues generated from Muslim conquests. Also, Muslim contributions to mathematical knowledge are substantial. There are no objections to appropriate use of mathematics and statistics, where relevant and useful. However, as McCloskey (1998, p. 36) points out via detailed argument, “Samuelson’s skill at mathematics ... is itself persuasive ... (even though) ... the mathematics itself is pointless.” It is the use of mathematics in cases where it adds nothing, or even distracts from key relevant issues, which led Milton Friedman to state that “. . . economics has become increasingly an arcane branch of mathematics rather than dealing with real economic problems.”

3.3 Economic Theories are Materialistic

Karl Marx believed in material determinism; that is the theory that all cultural and social movements and ideas are brought about by changes in economic and other material conditions. The forces that drive historical change are material in nature. This is why his doctrine is called “material determinism.” While not explicitly mentioned, these views are also built into foundations of modern Western economic theory. These have two important consequences which conflict with Islamic ideas:

One is that there is no room for God. Those in the West who believe in God subscribe to the clockmaker model: God created the universe and the causal mechanisms, and no longer interferes with it. The Quran is full of stories of how God intervened in the past, and also conditions required for receiving help from God, or interventions in the present.

Two is that there is no room for human beings. That is, visions, ambition, and ideologies are all constrained by material means. Indeed, Marx went so far as to say that even philosophies developed by men were determined by their economic circumstances. It is a delicious irony that his vision of a classless egalitarian society, where needs of everyone would be met, inspired millions of people in Russia and China. His ideas changed the world without any material means, contrary to his theories which hold material causes to be primary. This development was also contrary to his theories which held that agrarian societies would transition to capitalistic ones, prior to being led inexorably to the communist form.

Modern economic theory treats human beings as an input into a production function – they are a means for the creation of wealth. As consumers, they are solely driven by selfish utility maximization. The possibility that inspired leaders can change the destiny and fortunes of nation, as was accomplished by our Prophet Mohammad S.A.W., does not exist in these theories. The Quran states that:

8:63 And (moreover) He hath put affection between their hearts: not if thou hadst spent all that is in the earth, couldst thou have produced that affection, but Allah hath done it: for He is Exalted in might, Wise

The most valuable treasures of Allah, the community or Ummah created by the efforts of our Prophet Mohammad S.A.W., cannot be obtained by material means. Again this is in conflict with the methodological bases of western economic theories. Major failures of economic theories in the recent past have led some economists to consider invisible and immaterial causes for material progress. For example, Zak and Knack's (2001. Trust and growth, *Economic Journal*, vol. 111, 295–321) is a seminal study on trust and economic growth. Because it ignores the role of invisibles such as the quality of institutions, property rights, social norms, etc., "Existing economics ... bears little relation to what happens in the real world," according to Nobel Laureate Ronald Coase. However, these critiques are tentative and hesitant beginnings, which have not been widely accepted by mainstream economists. In fact, Islamic teachings offer us solid information far more advanced than that currently available to these dissenters from the mainstream, as we will discuss later.

3.4 Economic Theories are Positive (or Factual)

A dichotomy is made between positive and normative theories. Positive theories are factual and objective, while normative theories contains value judgements which cannot be empirically tested or verified. The claim is made that Western economic theories are positive. For example, Samuelson and Nordhaus write [Economics 17th Ed. Page 8]: "Positive economics describes the facts of an economy, while normative economics involves value judgements." Similar claims can be found in most conventional economics textbooks. As we discuss below, this claim is false. Predictions of economic theories are contradicted by observed behaviour of firms and consumers.

3.4.1 Consumer Behavior: Theory versus Observation

The field of behavioural economics has emerged as a result of observing actual behaviour of consumers, and comparing it with predictions of economic theories. The list of systematic discrepancies between the two is so large that

several book length treatments have been presented. Daniel Ariely in “Predictably Irrational” and Thaler in “Quasi-Rational Economics” have given large categories of examples where consumer behavior does not conform to utility maximization hypothesis.

Proven substantive conflicts between human behaviour and economic theory cannot be covered in a few short paragraphs. One line of investigation shows that it is necessary to take into account human drives for understanding, achievement, and feelings of reciprocity, trust, etc. in order to account for behaviour in different types of economic environments; Mahmood (2011) provides a guide to this literature in context of the labor market. Another line of research shows the importance of social norms in determining human conduct; see for example, Bicchieri (2006). Nobel Prize Laureate Herbert Simon showed replacing “maximization” by “satisficing” and “bounded rationality” leads to better descriptions of observed behaviour of humans. We give a few examples to show that consumer behaviour does not correspond to economic models.

1. Chapter 2 of Ariely entitled “The Fallacy of Supply and Demand,” illustrates the phenomenon of “anchoring.” Initial decisions regarding the value of new products are often arbitrary and made on the basis of context. Subsequently, these decisions are not revised in light of new information. Ariely provides many illustrations of how people make arbitrary decisions about price and value, and how these can be exploited by savvy marketeers to obtain high prices.

2. Consumer choices at cafeterias are systematically influenced by factors like the sequence in which choices are listed, contrary to predictions of economic theory. This can be used to “nudge” consumers towards healthy choices; see Thaler and Sunstein for a detailed discussion.

3. Empirical studies of the Vickrey 2nd price auctions show that people frequently bid over their private values. As Vickrey showed, bids exactly equal to the private value is the unique optimizing strategy, and overbids have the potential to result in losses. This observed behavior is due to a cognitive error, and has been demonstrated in many experimental studies of auctions, as reported in Kagel and Roth (1995).

Initial research in the field of behavioural economics was concerned with establishing contradictions between theoretical predictions and observed behaviour. These have been firmly established, and now the attention has turned to developing realistic theories which help explain actual behaviour. See Koehler and Harvey (2004) for many surveys of the diverse areas within this field.

3.4.2 Firm Behavior

Simple minded theories of profit maximization by firms fail to describe actual behaviour of firms in the real world. There are many areas of failure.

1. Efficiency wage theories show that firms often pay laborers higher wages than the marginal product. See Mahmood (2011) and Abbas (2006) for detailed discussion and guide to the extensive literature.

2. Theories of internal organization of the firm find that firms cannot be treated as a homogenous entity devoted to a single goal. Owners would like to maximize profits, but managers want to maximize their salaries and employees have other goals. The Principal/Agent literature is based on recognition of these conflicts. See Laffont and Mortimort (2001), who write that “the problems were so serious that a whole generation of ... theorists gave up the grandiose framework of General Equilibrium Theory .. to build a theory of incentives.”

3. Greenwald and Stiglitz (1990) have developed a theory of firms which takes into account informational asymmetry. Their theory corresponds to observed behaviour of firms but differs markedly from neoclassical theory.

4. Fundamental findings of the theory of Industrial Organization show that firms rarely behave in the way assumed in the theory of competitive markets as expounded in economics textbooks. A survey of ways in which observed behaviors differ from theoretical predictions is given in Kagel and Roth (1996, Chapter).

Commenting on the unrealistic theories, and complete lack of attention to empirical accuracy or validation, Bergmann (2007) writes that “The material about business behavior that students read about in economics textbooks, and almost all of the new theoretical material developed by mainstream professionals and published in the profession’s leading journals was composed by economists who sat down in some comfortable chair and simply made it up.”

3.4.3 Prices are determined by Equilibrium of Supply and Demand

The Great Depression showed that labor markets could stay out of equilibrium for a long time. Keynes explained this by saying that wages are rigid downwards, but offered no explanation for why this should be – but this is equivalent to saying that the standard demand and supply model breaks down in the labor market. Therefore the government must intervene to bring about

equilibrium. Long and persistent bouts of unemployment have been observed in many different countries, showing that labor markets do not clear at the supply and demand equilibrium. Many different types of explanations have been offered for this market failure; for a survey see Mehmood (2011).

More recently, Card and Krueger (1997) showed that contrary to predictions of the supply demand model, raising minimum wages may actually increase employment. In an interview about this finding, Card stated that:

To what extent does the simplest model of supply and demand actually describe how employers operate in the labor market? [Not very well. Alternatives to supply and demand theory explain] a lot of things that don't seem to make sense, at least to me, in a simple demand and supply model.

These created such a controversy that Card stopped doing research on this issue:

I've subsequently stayed away from the minimum wage literature for a number of reasons. First, it cost me a lot of friends. People that I had known for many years, for instance, some of the ones I met at my first job at the University of Chicago, became very angry or disappointed. They thought that in publishing our work we were being traitors to the cause of economics as a whole.

Zaman and Saglam (2010) have shown that the Marshallian theory of supply and demand as a mechanism for price formation in a single market, conflicts with general equilibrium theory. This means that the two could not be right at the same time. Since GET is a generalization to multiple markets of the principles by which the single market theory is derived, this shows that these principles lead to contradictory outcomes.

The foundations of economic theory, both micro and macro, are built upon supply and demand and the concept of equilibrium. We have shown that the consumer theory on which demand is built is not observed in actual behavior. Similarly, observed firm behavior does not conform to theoretical specifications. Finally determination of prices via equilibrium also does not hold empirically. Thus economic theory is not a positive theory, conforming to observations; rather it is an a priori, axiomatic, and mathematical theory directly in conflict with many observations about actual behavior. In recognition of the stark differences between observed behavior and economic theories, Stiglitz remarked that the theoretical "models (used) in America's graduate schools ... bear testimony to the triumph of ideology over science."

4. An Islamic Alternative

As we have shown, methodological foundations of western economic theory are fundamentally flawed. Mostly, Muslim economists have uncritically accepted claims that economic theory is “positive,” or factual, and many other methodological assumptions. Attempts to combine these with insights from the Islamic tradition have failed, because the two are in conflict. In my paper, “Islamic Economics: A Survey of Literature,” I have described at length the many many places where Islamic conceptions of economics differ radically from conventional ones. This paper is complex and lengthy. A somewhat simpler exposition, focusing directly on a point-by-point comparison of issues where there is a conflict between Islamic teachings and conventional Economics is given in my paper “An Islamic Critique of Neoclassical Economics.”

It is impossible to discuss all the differences between a genuine Islamic approach to economic issues and modern western conceptions within the space limitations of a short paper. Below, I will outline what I believe are three fundamental issues which would form the foundations of any Islamic approach to economic issues.

4.1 Transforming Human Beings

All actions of a Muslim, including the study of economics, are directed towards a single goal:

6:162 Say: "Truly, my prayer and my sacrifice (all my struggles and efforts), my life and my death, are (all) for Allah, the Cherisher of the Worlds:

The training given to the Companions by the Prophet Mohammad S.A.W. brought about a spiritual transformation, causing them to focus on the purpose and meaning of our existence as defined by the Quran. As Allah Ta`ala has stated:

*95:4 Verify, We create man in the best conformation;
95:5 and thereafter We reduce him to the lowest of low*

This means that there exists potential within human beings to rise above the angels, and also to become baser than the beasts. All of Islamic teachings, including those in the economic domain, are concerned with realizing this potential within man. The work of our Prophet Mohammad S.A.W. was to change men, who then changed the world, in accordance with the promise of the Quran:

13:11 Verify, God does not change men's condition unless they change their inner selves

This is the exact opposite of materialistic teachings, which hold that we must change material conditions to produce human welfare. Many practical people have come to this insight after having applied western recipes for economic development. For example, Mahbubul-Haq implemented policies for economic growth designed by experts from Harvard in Pakistan. The failure of these policies led Mahbubul-Haq to the conclusion that “We were told to take care of our GNP as this would take care of poverty. Let us reverse this and take care of poverty as this will take care of GNP.” That is, we must reverse priorities to emphasize human beings over materials. Martha Nussbaum, Amartya Sen, and many other thinkers have come to similar conclusions –providing capabilities to human beings is the central goal of development and also leads to economic development as a peripheral matter.

The area of human development is one where Islamic teachings offer us substantially more than what is currently available from the best western thinkers. The prophet Mohammad S.A.W. was the best of human beings, a perfect role model, and was also the best of teachers. The effect of his teachings was to create excellence in human beings. Secular thinkers can propose the idea of human development, but cannot agree on what it means. It has been correctly argued that normative propositions cannot be derived from observations and logic, which is all that is available to secular thinkers. Thus Sen is reduced to the idea of “Development as Freedom,” even though it is obvious that freedom is merely a means to an end, and not an end in itself. The idea that the best use of freedom is to surrender and become a slave of Allah cannot be found in secular thought.

It is impossible to summarize all the consequences of focusing on the development of human beings within the Islamic tradition. We will summarize three major contrasts with conventional economic thought below:

4.1.1. The Spiritual Focus

All of our acquisition of knowledge and our struggle to change the world occurs for the sole purpose of pleasing Allah *Subhanuhu wa Ta`ala*. This explicit spiritual focus characterizes the efforts of our Prophet Mohammad S.A.W. and differentiates Islamic Economics from any other existing approach. As the Quran states:

73:7 Lo! [the struggle to establish the Deen] keeps you very busy in the daytime.

73:8 So remember the name of thy Lord and devote thyself with a complete devotion

That is, even being busy with the struggle to establish the Deen during the daytime should not distract you from the remembrance of Allah, and some significant portion of the nights should be fully devoted to Allah.

The strong spiritual focus of Islam contrasts favorably with conventional materialistic approaches to economics. For example the currently fashionable idea of “Corporate Social Responsibility,” is sold on the basis that social behavior will generate more profits. But this leads to documentable emphasis on images and advertising, not a genuine concern with social problems. Similarly, many authors have argued that the audit failures which led to the Enron scandal are not unique, but an unavoidable part of a system where auditors are paid by firms being audited. Only a spiritual focus can ensure the existence of people who cannot be purchased at any price.

4.1.2 Moral Leadership and Training

The Prophet Mohammad S.A.W. was sent to the world as a teacher. Islamic economists must be concerned with moral training; being exemplars and teaching students to actively engage in the process of changing the world for the better. Not only must we urge the feeding of the poor, but we must teach our students to spread this message. Not just the outward action, but the inner dimensions, which consist of intentions and the feelings with which the action is done, are essential components of Islamic teachings.

21:107 We sent thee not, but as a Mercy for all the Creation

We must seek to develop this characteristic of mercy and compassion for all human beings within ourselves and our students.

Explicit concern with moral training, developing compassion and sympathy for others, contrasts with western abandonment of the moral mission of education. Reuben (1996) has described how conflicts between religion and science, as well as changing ideas about the nature of science, led to the abandonment of the moral mission of building character in American universities in the early twentieth century. Failure to instil morals has led to a “terrible failure,” as the following quote from Harvard Professor Zuboff (2009) indicates:

“I spent a quarter-century as a professor at the Harvard Business School, including 15 years teaching in the MBA program. I have come to believe that much of what my colleagues and I taught has caused real suffering, suppressed wealth creation, destabilized the world economy, and

accelerated the demise of the 20th century capitalism in which the U.S. played the leading role.

We weren't stupid and we weren't evil. Nevertheless we managed to produce a generation of managers and business professionals that is deeply mistrusted and despised by a majority of people in our society and around the world. This is a terrible failure.”

4.1.3 Engagement and Struggle as a Means to Knowledge

According to many sayings of the Prophet Mohammad S.A.W., we cannot remain detached and neutral; when we see oppression, injustice or other social evils, we must act to change them. Furthermore, it is in the process of this struggle that we will be given the required knowledge:

29:69 And those who strive in Our (cause)- We will certainly guide them to our Paths: For verily Allah is with those who do right.

Thus Islamic Economists must seek to change the world to bring about economic justice, to urge the feeding of the poor, and to implement orders of Allah relevant to the economic realm in our own lives and in the lives of our students. It is essential for moral training and leadership to engage with the world in ways prescribed by Islam; this is how the Prophet Mohammad S.A.W. trained the Companions. Thus, Islamic Economics is neither positive, nor normative, but it is transformative. We do not seek to study the world (positive), nor do we seek to describe an ideal state of affairs (normative). We struggle with the world we see in the ways prescribed by Islam, to generate the same type of radical changes created by the struggle launched by our Prophet Mohammad S.A.W. and his Companions.

This is in sharp contrast to western methodology, which advocates the stance of a detached observer. In their capacity as scientists, western economists seeks to discover universal laws, and have nothing to say about policy matters, which involve normative decisions. Reuben (1996) has described how conflicts between religion and science, as well as changing ideas about the nature of science led social scientists to abandon the role of activists and reformers working to bring about a better world in favour of the detached observer role of the Baconian scientist.

The process of transforming men from lower than the beasts to higher than the angels has many dimensions, which cannot be covered or even mentioned here. From these, we pick two which are central to economics, and contrast

maximally with conventional economics. The contrast can be summarized by saying that western economic theory is founded on “selfishness and competition” while Islamic economic systems are based on “generosity and cooperation.” The reason for focusing on these two is that one is the basis for individual behavior while the second is the basis for social behavior. Together, the two provide the foundations for Islamic views on economic affairs.

4.2 Greed versus Generosity

The Quran is full of verses exhorting people to spend for the sake of Allah. Kahf (undated) writes that there are many more verses on this topic than on the famous five pillars of Islam. A few are cited below:

16:90 BEHOLD, God enjoins justice, and the doing of good, and generosity towards [one's] fellow-men

2:274 Those who (in charity) spend of their goods by night and by day, in secret and in public, have their reward with their Lord: on them shall be no fear, nor shall they grieve.

Muslims are commanded to spend money in excess of our needs for the sake of Allah.

Q2: 219 They ask thee how much they are to spend; Say: "What is beyond your needs."

The generosity of our Prophet Mohammad S.A.W., who is the perfect role model for us, is well known. He never turned away anyone who sought his help. After observing how much he gave out of the wealth that accrued to the Muslims after the conquest of Mecca, Safwan bin Umayyah remarked that “(the prophet) was as generous as the rain.”

This is in sharp contrast with western economic methodology which attempts to explain all economic behavior as a consequence of selfishness and greed. Many papers have been written attempting to explain charity and generosity as being a manifestation of long-run selfishness. However, the Islamic act of charity is motivated by the love of God alone, and also Muslims expect compensation from Him alone:

[Q76:8,9] and who give food - however great be their own want of it - unto the needy, and the orphan, and the captive, [saying, in their hearts,] "We feed you for the sake of God alone: we desire no recompense from you, nor thanks".

Genuine Islamic teachings in the economic domain must have the effect of creating generosity and spending on others. This requires that teachers model this behavior and also teach it to students. This can be done by engaging in projects to help the poor and disadvantaged. Such practical experience must be an important part of any Islamic curriculum of studies. This contrasts with western economic teachings which promote selfishness. Many studies have documented that economists tend to be more selfish than others; see for example Kirchgässner (2005).

4.3 Cooperation versus Competition

As a broad general principle, Islamic systems in all spheres are built with the goal of promoting community feeling and cooperation among all members of society:

Q3:103 And hold fast, all together, by the rope which Allah (stretches out for you), and be not divided among yourselves; and remember with gratitude Allah's favour on you; for ye were enemies and He joined your hearts in love, so that by His Grace, ye became brethren;

Q2:5 Help ye one another in righteousness and piety, but help ye not one another in sin and rancour

People are urged to cooperate with each in doing good; to look after needs of others like they would their own. The whole Ummah is one body and pain in one part is felt by the whole. The brotherhood and love between the hearts of the Muhajirin and Ansar is more valuable than all the treasure in the world.

Q8:62,63 He it is who has strengthened thee with His succour, and by giving thee believing followers whose hearts He has brought together: [for,] if thou hadst expended all that is on earth, thou couldst not have brought their hearts together [by thyself]: but God did bring them together. Verily, He is almighty, wise.

A cooperative attitude has very different consequences from a competitive one. In particular the market for insurance under cooperation will not suffer from the problems of moral hazard and adverse selection; see Zaman (2011) for details.

If selfish profit maximization is the norm, then cooperation between firms will have adverse consequences as they will collude against the consumers. This why guilds were eventually banned, and laws exist preventing firms from

collusive behavior even today. If Islamic ideals of service prevail, then firms will cooperate to provide the best possible service to the society, being oriented towards the spiritual and the rewards of the *Akhirah*. This is not just a pie-in-sky vision, but an ideal that was achieved in Islamic societies through the institutions of *awqaf*. This has been documented in many different sources.

Modern economic theory has been strongly influenced by (and also influenced) the theories of evolution. Competition among individuals leads to weeding out the unfit, and survival of the fittest brings benefit to the race as a whole. This is taken as the natural state of affairs. Profitable firms will survive, and this will improve efficiency of the economy. The laws of the jungle do not apply to a society where human beings are spiritually developed, as occurred in Islamic history through the training of the Prophet Mohammad S.A.W. The Quran bears testimony to the fact that the Companions fed others while being themselves hungry, and also acted in ways to earn the pleasure of Allah even while in this world. They transmitted these teachings to their followers and these visionary ideals served as the standards of excellence in Islamic societies for a long time.

5. Answers to Common Objections

The ideas proposed as the foundations for an Islamic Economics run into several common objections which we will raise and answer here.

5.1 Normative Ideals cannot be compared with a Positive Theory

The **objection** is that our descriptions of Islamic Economics refer to an ideal state of affairs, a normative idea. Conventional theory is positive; it describes the ground realities. The two cannot really be compared, and it is unfair to contrast a theory which describes ground realities of human existence with some visionary ideals. If we look at actual Muslim behavior in Islamic countries, we will find that it corresponds far better with theories of economic texts and not much (if at all) with the Qur'anic ideals described above.

This objection can be answered in two different ways.

The **first answer** is that Islam does not seek to describe the world, it seeks to change the world. The Message of the Prophet s.a.w. did not present a detailed critical analysis of the Jahilliyah, but only focused on describing those elements which required changing to conform with Islam. The methodology of western science prizes descriptive accuracy, but Islam is concerned with creating change, and describes the most effective techniques to bring about changes in human beings. One of these techniques to describe a high set of

ideals and persuade people to work to achieve excellence. The goal of the normative ideals to set the direction for the struggle, even though the ideals are themselves unachievable. This is exactly as the North Star sets the direction for the journey, even though one will never reach the star.

The **second answer** is that economic theory is itself not a positive theory. In fact, it also creates a vision of an ideal market society, where there is “perfect” competition, firms and consumers are price takers and do not seek to collude or monopolize, there are no transaction costs, information failures, or externalities, etc. etc. It is freely acknowledged that the idealized conditions of perfect competition have never actually been realized in any real world economy, but it is nonetheless proposed as an ideal to strive for, due to its wonderful theoretical properties. Viewed in this light, there is not much difference methodologically between the two approaches. However the imagined ideal of cut-throat competition, and survival of the fittest in a jungle conflicts strongly with Islamic ideals.

5.2 One must use material means to bring about changes

Acknowledging the excellence of Islamic ideals still does not give us a clue as to how these could be achieved in the real world. Any line of action undertaken must work through the practical reality; that is, it must be embodied in real world institutions and real world economic policies. Based on these ideas, an **objection** can be phrased as follows. Political and economic realities constrain and determine the path of motion of societies. The gap between lofty ideals and ground realities is too large to have any real effects. Thus one must study material means and causal laws of motion of politico-economic systems, like a western scientist, in order to bring about change.

To **answer** this objection, we must argue that the materialistic theory of how the world works is wrong. It is not true that ideals and visions do not affect the material world. If we look at the trajectory of the rise of Islam, we cannot find any material cause for it. The Bedouin Arabs were backwards in all ways. The Prophet S.A.W. did not teach them any new martial skills, or equip them with technical knowledge, or provide them with industry which would furnish a material basis for their advance. Rather he inspired them with a vision and Islamic ideals, and they went on to change the world.

We offer several pieces of evidence to show how abstract and immaterial ideals and visions influence the course of history, without material means. The case of Karl Marx is especially interesting. His visions of a classless society where people would receive “according to their needs,” with justice, equality and brotherhood, inspired millions and changed the course of history. His own

deterministic analysis of how the mechanical and material forces would shape economic trajectories proved to be completely wrong. On a more pedestrian level, Karen Pfeifer (2001) has analyzed the wage-profit shares for different firms in Egypt. She finds that Islamic firms in Egypt offer significantly higher wages (and have lower profits) than comparable non-Islamic firms, which have higher profits and lower wage shares. Similarly Najam (2007) studies philanthropy among immigrant Pakistanis in the USA. He finds that they contribute substantially more to charity than other communities with comparable income. Furthermore, these contributions are the effect of Islamic injunctions. Studies of recent earthquakes in Pakistan showed huge public response, overwhelming the official government response. Furthermore, this response was much larger than the public response to comparable catastrophes in non-Islamic countries (i.e. New Orleans). All of this shows that, contrary to materialist views, visions and ideals do affect the real world, even when they are very imperfectly practiced.

5.3 Islamic ideals are not realistic and practical

The **objection** is that the ideals described above are not in tune with human realities. Even the Quran describes how human beings can be greedy and selfish, love luxuries and chase after idle desires. The lofty ideals simply cannot be achieved. A realistic theory must be more concretely tied to the ground realities of Islamic societies that we observe in the world around us.

To **answer** this objection, we must look at the descriptions of *Jahiliyah*, the age of ignorance that prevailed prior to the advent of Islam. This closely resembles modern society; both are characterized by massive oppression and injustice, and the exploitation of the weak by the strong. The Quran explicitly forbids the concentration of wealth in the hands of a few, which is an important cause of this outcome. Today, as Stiglitz (2011) writes, ‘the top 1% in the USA own 40% of the assets in the country.’ Referring to trillion dollar wars and trillion dollar bailouts of wealthy firms, Carter (2011) writes ‘In America, the top 1 percent led the country into war and economic devastation, leaving the less fortunate to fight for one and pay for both.’ Bankers threw millions out of their homes for nonpayment of interest after the financial crisis of 2008. Loose sexual mores, alcohol and drugs, and many other social evils associated with modern societies are characteristics of the *Jahiliyah*. Strikingly, even the practice of burying daughters alive finds parallels in the modern age. In order to prevent death of thousands of babies abandoned in trashcans, ‘safe haven’ laws have been enacted in many states in the USA. These allow mothers to abandon children at specially designated hospitals, without being asked any questions.

Islam brought the light of knowledge, and revolutionized the world. History bears testimony that the ignorant, illiterate and semi-barbaric Arabs created a civilization which dominated the world for a thousand years. It was prophesied that ‘Islam came as a stranger and will soon become a stranger.’ So it is today, when we look at the lives of the Muslims and find in them every evil that Islam prohibits. Islam has become a stranger to Muslims, and that is precisely what gives rise to the question and objection under discussion in this section.

Answering this objection requires faith in Islam. Islam has the same power to revolutionize the world today as it did fourteen centuries ago. The message of Allah, in the shape of Islam, is the greatest gift to Mankind:

Q5:3 This day have I perfected your religion for you, completed My favour upon you, and have chosen for you Islam as your religion.

Not only has Islam become a stranger to the Muslims, but the Muslims have stopped believing that their religion contains complete and perfect guidance for our problems of today. The vast majority believe that the solution of our problems today lies in acquiring science and technology, and social and political institutions of the west. In fact, as was the case fourteen centuries ago, the basic lesson of Islam in terms of spirituality, *taqwa* tawakkul, tabattul, as well as the excellence in conduct modeled by our prophet is sufficient to solve our problems of today. The problems of the Islamic world will not be solved by Foreign Investment, IMF, democracy, and institutional reform. Rather, if individuals strive for achieving the potential within them, and create a society based on the concept of the Ummah as one body, replicating the efforts of the Prophet S.A.W., then we can also replicate his success.

6. The Challenge and the Opportunity

The spectacular failure of economic theory in the recent global financial crisis of 2008 is open for all to see. Responding to questions about this failure, former United States Treasury Secretary Larry Summers implicitly agreed that academic “economists did not understand what was going on.” Testifying before a Congressional Committee setup to investigate this failure, many prominent economists blamed dominant economic theories. Despite the fact that many Nobel caliber economists have written devastating critiques, the economics profession has not responded by making changes to the conventional syllabus and hiring practices. This is because about 5000 Ph.D.’s produced each year, and mechanisms for evaluations, tenure and publications, carry a huge momentum which cannot easily change direction. When the Japanese invented the fourth generation steel furnaces, the US Steel Industry was unable to follow

suit, because they could not scrap their huge investment in obsolete technology. A similar situation currently obtains in economics.

This gives us in the Islamic world a tremendous opportunity to build an Islamic economics on new foundations. In the East, we do not have heavy investments in obsolete knowledge forcing us to stay on the dead-end treadmill of neoclassical economics. The message of this paper cannot be heard by western economists because it destroys all their intellectual capital. Muslim economists also have to be prepared to abandon a lot, but they have a platform to which they can jump for safety. The Quran gives us deep wisdom about how to manage economic affairs of a society. While many new and radical schools of thought have become prominent after financial crisis of 2008, nearly all look at partial remedies to the problem, because no one has an alternative foundation, a coherent worldview radically different from that fostered by the failed methodologies of materialism and logical positivism. This is what Islam and Islamic teaching in the economic realm provide us today: an opportunity to lead the world out of the morass it currently is in. As it was fourteen hundred years ago, so it is true today that the Quran provides us with complete and perfect guidance.

7. References

- Ariely, Dan** (2008) *Predictably Irrational: The Hidden Forces That Shape Our Decisions*, Collins
- Behdad, Sohrab** (1994) "A Disputed Utopia: Islamic Economics in Revolutionary Iran," *Comparative Studies in Society and History*, **36**(4), (Oct.), :775-813.
- Bergmann, Barbara** (2007) "Needed: A New Empiricism," *Economists' Voice*, March
- Biccieri, Cristina** (2006) *The Grammar of Society: the Nature and Dynamics of Social Norms*, Cambridge University Press.
- Bruce, C. Greenwald and Joseph, E. Stiglitz**, (1990) Asymmetric Information and the New Theory of the Firm: Financial Constraints and Risk Behavior *The American Economic Review*, **80**(2), Papers and Proceedings of the Hundred and Second Annual Meeting of the American Economic Association (May, 1990), :160-165
- Card, D. and A. Krueger** (1997) *Myth and Measurement: The Economics of the Minimum Wage*. Princeton University Press.
- Chapra, Umer** (2000) *The Future of Economics: An Islamic Perspective* (Leicester: The Islamic Foundation).
- Kahf, Monzer** (2007) "Infaq in the Islamic Economic System," Undated. Available from monzer.kahf.com accessed 30 June 2007.
- Koehler, Derek J. and Nigel Harvey** (Nov 22, 2004) *Blackwell Handbook of Judgment and Decision Making*.
- Kirchgässner, Gebhard** (2005) (Why) are economists different? *European Journal of Political Economy*, **21**(3): 543-562.
- Kung, Hans** (1980) *Does God Exist? An Answer For Today*.

- Laffont, Jean-Jacques and Martimort, David** (2001) *The Theory of Incentives: The Principal-Agent Model*, Princeton University Press, Princeton, USA.
- McCloskey, D.** (1998) *The Rhetoric of Economics*.
- Mehmood, Saima** (2011) *Efficiency Wages and Non-monetary Motivational Strategies: An Experimental Approach*. Ph.D. Thesis, PIDE, Islamabad, Pakistan.
- Joel Michell** (2003) "The Quantitative Imperative, Positivism, Naïve Realism and the Place of Qualitative Methods in Psychology," *Theory and Psychology* 13(1): 5-31.
- Mirowski, Phillip** (1990) *More Heat Than Light*.
- Najam, Adil** (2007) *Portrait of A Giving Community: Philanthropy by the Pakistani-American Diaspora*, Harvard: Harvard University Press, 2007.
- Olson, Richard** (1995) *Science Deified and Science Defied*, Thaler and Sunnstein, *Nudge: Improving Decisions About Health, Wealth, and Happiness*.
- Siddiqi, Muhammad Nejatullah** (2008) "Obstacles to Research in Islamic Economics," in Proceedings of The Seventh International Conference on Islamic Economics, <http://islamiccenter.kaau.edu.sa/7iecon/English/English%20Contents.htm>
- Stiglitz, J.E.** (2011) "Of the 1%, By the 1%, For the 1%," Vanity Fair, May 2011.
- Zaman, Asad** (2007) "An Islamic Worldview: An Essential Component of an Islamic Education," *Lahore Journal of Policy Studies*, 1(1): 95-106, June 2007.
- Zaman, Asad** (2008) "Improving Social Science Education in Pakistan," *Lahore Journal of Policy Studies*, 2(1), June 2008.
- Zaman, Asad** (2009) "Origins of Western Social Science", *Journal of Islamic Economics, Banking and Finance*, 5(2), May-August 2009, pp: 9-22
- Zaman, Asad** (2011) "Contrast between Islamic and Economic Views of Incentives" *Journal of Islamic Economics, Banking and Finance*, to appear 2011,
- Zaman, Asad and Saglam, Ismail**, "The Conflict between General Equilibrium and the Marshallian Cross,"
- Zuboff, S.** (2009) "The Old Solutions have become the New Problems," Bloomberg Business Week, July 2, 2009. Available at: http://www.businessweek.com/managing/content/jul2009/ca2009072_489734.htm

أزمة الاقتصاد الإسلامي: التشخيص والحلول

أسد زمان

معهد الاقتصاد الإسلامي العالمي

اسلام آباد - باكستان

asadzaman@alum.mit.edu

المستخلص. هناك شواهد كثيرة تؤكد أن الاقتصاد الإسلامي يعاني من أزمة حالياً. وهذا المقال يرجع السبب الرئيسي لهذه الأزمة إلى أن معظم الاقتصاديين المسلمين قد قبلوا كثير من أفكار الاقتصاديين الغربيين بدون نقد لها، في الوقت الذي كان الإطار المنهجي والافتراضات الغربية غير صحيحة وتتعارض مع وجهة النظر الإسلامية ولم يتم التعرف على هذا التناقض وفشلت المحاولات لدمج تلك المعارف المتناقضة ويعرض المقال أسس بديلة يمكن بموجبها بناء نظرية اقتصادية إسلامية.