

# Developing and Promoting “Economic & Financial System of Islām”: Some Suggestions

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## Abstract

More than three decades ago a group of Muslim economists took the burden of developing a model of economic and financial system of Islām (EFSI) and reform the existing western systems in contemporary Muslim economies. Today, although we find a rapidly expanding Islāmic financial industry, it remains far from achieving the goals initially set for different sectors of this discipline. Leading Islāmic economists of our era are accepting the failure of Islāmic economics and some suggestions are made both about the underlying reasons as well as possible solutions. This paper first describes the goals and objectives of an Islāmic economic system. It argues why an EFSI, deriving its principles from Islāmic sources of knowledge, should put special emphasis on economic justice and equitable distribution of income. It then points out some basic features of the capitalist economies that are in conformity with an Islāmic economic system and discusses the shortcomings of the neoclassical school which provides the intellectual background for the capitalist system. These two exercises lead to comprehend the reasons for our failure: not addressing the issue of distribution of income and putting too much effort in criticizing the neoclassical assumptions on behavioral norms. This paper suggests areas where efforts should be made to transform the existing capitalist system into sustainable Islāmic economies based on Islāmic principles of socio economic justice.

**Key words:** Islāmic Economics, Capitalist System, Neoclassical School, Heterodox Economics, Islāmic Economic and Financial System

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## 1. Introduction

Muslim scholars and intellectuals of every era specializing in different areas of human lives are supposed to understand new realities and complexities of their time, evaluate the models of existing institutions and, accordingly, suggest possible changes and solutions ensuring that they are in conformity to Islāmic teachings. The task of providing solutions for new situations and complexities would always be difficult, but more challenging whenever Muslim communities attempted to resurrect after colonial or foreign domination. Furthermore, the longer and deeper the dominance, the more demanding and complex would be the task.

This is exactly the situation Muslims have been facing since the middle of the 20<sup>th</sup> century. Muslim lands did not merely face foreign military occupation, but new and powerful doctrines and accompanying institutions were also instilled at varying levels in many areas of life - political, economic, legal, educational, social and cultural. One of the outcomes of this dominance was the segregation of religious and non-religious educational institutions which generally produced two different groups of intellectuals. The latter, by and large, followed the curriculums of the west not only in physical sciences (which was universal and hence mostly beneficial) but also in areas such as economics and sociology where everything could not be accepted without proper scrutiny.

The result of this segregation was that Muslim scholars studying in non-religious institutions were not properly equipped to study western advancement in social sciences with necessary Islāmic outlook. On the other hand scholars studying at religious schools lacked more recent advances in different areas of social sciences. All this led to emergence of three different groups of opinion makers in the Muslim world. One group looks at everything western with some suspicion and wishes revival of Islāmic ideals in socio-economic areas often by referring to the past practices and achievements. The other group, being more subtle than the first one, is against bringing religion into subjects such as economics and politics. This group is educated and impressed by the achievements made through western advancements in natural as well as in social sciences not confined to west but spreading to Muslim lands and beyond. It must be said, however, that all members of this group are not necessarily anti religion or secular; some of them simply don't see how (old) religious doctrines could be applied to modern economies and societies or how introducing any reform based on religious teachings could work and improve the existing institutions. The third group refers to those who

recognize the achievements made through western scholarship. However, they are critical of some of the undesirable consequences of this advancement made and the institutions created during its progression. It recommends a thorough study not only of Islāmic teachings related to social issues of our time but comprehending the western doctrines and their conveying institutions for reconstruction or reformation.

In my view, it is the second group which has the dominant influence on the political forces of almost all Muslim countries whether the countries' names carry an Islāmic prefix or not. It appears that the literature created in the area of Islāmic economics has so far been not able to impress this second group of Muslim intellectuals. Even ordinary Muslims are not sure about the salient features of an Islāmic economic and financial system as to how it is different from the existing capitalist system.

It is, therefore, important to make progress in not only an elaborate design of an Islāmic economic system but also provide necessary detail about each of its sub-systems. The arguments made in favor of each of its sub-systems and about the overall outcomes of the system should be meaningful and convincing; not only for those who have remained critical or skeptical of an Islāmic system but also for those who may support an Islāmic economic and financial system in principle but are not sure about its actual characteristics and prospective implications.

A concerted effort would then be necessary to introduce and propagate the system to the authorities and officials of the existing governments as well as political organizations wherever they may exist. Such details may also be presented in a simple language for the general population so that they could understand the philosophy and objectives of an Islāmic economic system and easily envision its practical outcomes. However, the big question is how an Islāmic system would be different from the existing system and what are the key changes that need to be made in the current capitalistic system to conform to the Islāmic system? Before we answer this question, let us briefly review the progress made so far in defining and implementing features of an Islāmic economic system.

## **2. The Progress Made So Far**

Although several attempts to formulate an economic and financial system were made by individual Muslim scholars earlier<sup>2</sup>, the first conference

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<sup>2</sup> For example, Gilani (1947), Maududi (1969), AlSadr (2000).

held in Jeddah in 1976 after the 1973 Arab Israeli war and the historical hike in oil prices<sup>3</sup> was a milestone in providing some concrete ideas and suggestions for different segments of an Islāmic economic system. The second conference was held after seven years in 1983 at Islamabad, Pakistan, where General Zia-ul-Haq was taking some steps (not always uncontroversial) to introduce Islāmic economic and financial reforms. This conference also attracted leading Muslim economists. The proceedings and the revised versions of the papers were published in books and have remained valuable to this date. The venue for the third conference which was held in 1992 was the Capital of Malaysia, an emerging and rising member of OIC. However, this conference was not as successful in gathering as many prominent Islāmic economists and the quality of papers also could not match those presented during the first two conferences.

The 4<sup>th</sup> conference held in 2000 at Loughborough saw the emergence of a new generation of Islāmic economists and financial experts.<sup>4</sup> Since then, this series of conference is held every two to three years and has been attracting an increasing number of researchers in Islāmic finance but relatively less in the core areas of economic theory. While one should not overlook the numerous conferences that are being held all over the world outside the ambit of this series, none others are so widely attended.

Where have all these efforts led to? What are the policy implications of all the research done to date? Has it attracted the attention of policy makers in different Muslim countries? Has it impressed the economists, commercial and central bankers and fiscal and financial experts who were trained in conventional economics and finance and have continued to work in institutions created under the influence of that convention? Are the masses aware of the kind of policy implications emanating from our

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<sup>3</sup> To give a brief history of such conferences: The First Conference in the series was held in Makkah Al Mukaramah in 1976 under the auspices of King Abdulaziz University (KAU), Jeddah and it marked the start of development of Islāmic economics and finance as modern scientific disciplines; the Second in Islamabad, Pakistan, in 1983 under the auspices of the International Islāmic University, Islamabad; the Third in 1992 at the International Islāmic University, Selangor, Malaysia; the Fourth in 2000 at Loughborough University, U.K; the Fifth in Bahrain under the auspices of Bahrain University in 2003; the Sixth in 2005 in Jakarta under the auspices of Ministry of Finance and the Central Bank of Indonesia; the Seventh in Jeddah under the auspices of KAU in 2008; Eighth in 2011 in Doha, State of Qatar and the Ninth in Istanbul, Turkey in 2013.

<sup>4</sup> For example, Abdul Azeem Islahi, Kazem Sadr, Sami Ibrahim Al-Suwailem, Habib Ahmad, Abdel-hameed Bashir and others.

research? Are the major political parties of different Muslim countries cognizant of the nature and scope of Islāmic economic and financial reforms? Has the dominant school of conventional economics or others among heterodox economics traditions taken any notice of the developments made in Islāmic economics and finance literature?

## **2.1 What About the Phenomenal Growth of Islāmic Banking & Finance?**

The most important achievements of research in Islāmic economics and finance have been the establishment of Islāmic banks, *takāful* companies, Islāmic mortgages, *ṣukūk*, Islāmic stock market indexes, Islāmic funds, etc; all in the area of banking and finance. The establishments of AAIOFI and IFSB have provided helpful services to Islāmic financial institutions. Although their recommendations are only advisory, they nevertheless provide an important base for powerful regulatory regimes for Islāmic financial institutions.

While Islāmic banking and financial institutions are still far from their original goals and as, for different reasons, have often used the products of conventional financial institutions, they did not necessitate any substantive changes in monetary policies of Muslim countries. The theoretical research carried out in the area of monetary economics and their policy implications has so far remained untested even though this was the area that had attracted the attention of prominent Islāmic economists. Siddiqui (2010) discusses the status of current Islāmic banking and the need for establishing a meaningful profit and loss sharing Islāmic banking (PALSIB). He sketches a road map and argues for a gradual approach to accomplish this colossal task.

## **2.2 The Failure of Islāmic Economics?**

This author is tempted to reproduce the views of some of the leading Islāmic economists of our time as quoted by Asad Zaman (2012) in his article, “*Crisis in Islāmic Economics: Diagnosis and Prescriptions*”.

Umer Chapra (2000, p 375) writes:

“... Islāmic economics has been unable to come to grips with ... the problems faced by Muslim countries.”

Nejatullah Siddiqi (2008) writes:

“All is not well with Islāmic 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 “*Islāmic Economics: What Went Wrong*” writes: “Besides, Islāmic economists did not provide any agenda for political economics founded or derived from their branch of human

knowledge in spite of the need for such an agenda. It seems to me that the present generation of Islāmic economists is exhausted and already consumed in the activities of Islāmic 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.”

As for the critics of Islāmic economics, Zaman mentions two of them:

“Critics have been much harsher. For example, Sohrab Behdad (1994) talking about attempts to implement Islāmic Economics in Iran under Ayatullah Khomeini writes that “It has become apparent that Islāmic Economics is not capable of presenting a viable social alternative.” Similarly, Timur Kuran (1997) writes: that “Islāmic economics did not emerge from a drive to correct economic imbalances, injustices, or inequalities ... (but to) restore Islāmic community’s self-respect. Because Islāmic 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 Islāmic Economics has no substance or content. It is simply a part of an effort to create a differentiated Islāmic identity.”

The views presented above and the questions raised in this paper are important and answering them may help us in measuring the impact of our literature on formulation of economic policies in Muslim countries and standing of Islāmic economics and finance in general. It would also put some light on the reasons and the nature of our shortcomings and may guide us towards possible strategies and solutions.

Asad Zaman finds the reason for the failure in erroneously following the framework of neoclassical economics. He criticizes the behavioral assumptions of neoclassical school and suggests a complete breakaway from that tradition. In his view, the goals and objectives of Islāmic economics could not be achieved unless a proper methodology is adopted. Further, the route to realize these goals is through exerting all our efforts towards rebuilding the individual characters of Muslim individuals.

Before I suggest the conclusions of my own reflections on the failure of Islāmic economics, let us refer to the goals and objectives of an Islāmic economic system that were earlier presented in Siddiqui (2000).

### **3. The Objectives of Islāmic Economics and Finance and Means to Achieve Them**

According to Monzer Kahf (1989), "Any economic system should be founded on an ideology which provides the economic system with its basis

and objectives on one hand and its axioms and principles on other".<sup>5</sup> He further adds that, "The validity of an economic system can be tested by its internal consistency, its compatibility with the systems organizing the other aspects of life, and its provision for improvement and growth".<sup>6</sup>

What are the bases and objectives of Islāmic economics and finance and what are its axioms and principles? According to Umar Chapra, the goals and values of Islāmic economics could be broadly described as followings:<sup>7</sup>

- a) Economic well-being within the framework of the moral norms of Islām;
- b) Universal brotherhood and justice;
- c) Equitable distribution of income; and
- d) Freedom of the individual within the context of social welfare.

In Tag el-Din's view, an Islāmic economic system would provide economic policies guided by the Qur'ān and *Sunnah* in facing the economic problems. For him, the focus of Islāmic economics is the normative interventionist policies made necessary because of the greed of human beings. Hence, Islāmic economics, for Tag el-Din, becomes a tool to enlighten policy-makers, and help them take the right decisions. Consequently 'the analytical part of economics becomes a secondary requirement, since one must know what *is* in order to be able to suggest what rationally *ought to be*'.<sup>8</sup>

For Asad Zaman 'Islāmic Economics is the EFFORT/STRUGGLE to implement the orders of Allah (swt) pertaining to economic affairs in our individual lives (Micro), in our communities (Meso), and at the level of 'ummah (Macro)'.<sup>9</sup> He also emphasizes that 'this definition (of Islāmic economics) opens the way to radically new approaches, which can fulfill the promise initially held out by Islāmic Economics.<sup>10</sup> This (now largely forgotten) promise was that Islāmic Economics will provide justice, and

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<sup>5</sup> Kahf, Monzer (1989 a), p. 43.

<sup>6</sup> Monzer Kahf (1989).

<sup>7</sup> Chapra (1979).

<sup>8</sup> Please see (Kahf, 2003: pp. 26–7).

<sup>9</sup> Asad Zaman (n.d.), Re-defining Islāmic Economics.

<sup>10</sup> We can assume this would include the goals and objective enumerated by Chapra above.

eliminate oppression and inequities associated with capitalist, communist and socialist economic systems.<sup>11</sup>

According to Siddiqui (2000), there are two *interrelated* basic objectives of different systems organizing economic, social and other aspects of life in a Muslim society.<sup>12</sup> First, is to implement the commandments of the Creator. The second objective is to *help* its people in leading their individual and collective lives according to the teachings of Islām. To elaborate on these two objectives I would like to quote the following verses of the Qur'ān:

"Whatever [spoils taken] from the people of those villages God has turned over to his Apostle \_\_ [all of it] belongs to God and the Apostle, and the near of kin [of deceased believers], and the orphans, and the needy, and the wayfarer, so that it may not be [a benefit] going round and round among such of you as may [already] be rich. Hence, accept [willingly] whatever the Apostle gives you [thereof], and refrain from [demanding] anything that he *withholds* from you; and remain conscious of God: for, verily, God is severe in retribution." (59:7; my Italic)<sup>13</sup>

"O You who have attained to faith! Do not devour one another's possessions wrongfully \_ *not even* by way of trade based on mutual agreement \_ and do not destroy one another: for, behold, God is indeed a dispenser of grace unto you! And as for him who does this with malicious intent and a will to do wrong \_ him shall We, in time, cause to endure [suffering through] fire: for this is indeed easy for God." (my Italic) (4: 29-30)<sup>14</sup>

"O children of Adam, take your adornment at every masjid, and eat and drink, but be not excessive. Indeed, He likes not those who commit excess". (7:30)<sup>15</sup>

"And [they are] those who, when they spend, do so not excessively or sparingly but are ever, between that, [justly] moderate". (25:67)<sup>16</sup> and

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<sup>11</sup> Asad Zaman (n.d.), Re-defining Islāmic Economics.

<sup>12</sup> Siddiqui (1998).

<sup>13</sup> (59:7), as translated by Muhammad Asad in the *Message of The Qur'ān*.

<sup>14</sup> Asad Muhammad, *The Message of The Qur'ān*. It is important to note that in the translation of this *ayah*, Asad has adopted the meaning of " *illah* " as *not even* instead of its usual meaning *except*. Please see his explanatory note # 38 of Chapter IV. However, for our current purpose any of these meanings is appropriate although the one adopted by Asad is more forceful. As I understand, it implies that economic or business transactions must be based on inherent justice and not only apparent agreement of the concerned parties.

<sup>15</sup> <http://quran.com/7>

<sup>16</sup> <http://quran.com/25>



“Hence, do not covet the bounties which God has bestowed more abundantly on some of you than others. Men shall have a benefit from what they earn, and women shall have a benefit from what they earn. Ask, therefore, God [to give you] out of His bounty: behold God has indeed full knowledge of everything”. (4:32)<sup>17</sup>

In the first verse authorities in Muslim societies are asked to take affirmative action to prevent concentration of wealth in the hands of a few, *even if* the income or wealth was acquired through proper means. It is also important to note that individual Muslims are asked to willingly accept any government decision to take away part of their income that they might have earned lawfully.

On the other hand, individual Muslims are asked not to do any wrong doing while striving to make and sustain their livelihoods and not to be envious of others if they find themselves less successful in that strive. They are also told neither to be extravagant nor miserly. Apart from the above verses, the Qur’ān prohibits Muslims from business transactions involving *ribā* and *maīsir*. While all these remain (primarily) the responsibility of individual Muslims, the system established collectively by (or for) the Muslim populations should be helpful in obeying their Creator’s commands given to them at the individual level. Establishment of a better distribution of income is a command that must be fulfilled by Muslim societies through the authorities but it would also help individual Muslims in controlling and curbing their bad human instincts such as jealousy and foul-play in business dealings. Similarly, institutions such as interest free banking, *takāful* companies, Islāmic stock markets, etc., will help individual Muslims in obeying the command of their Creator given to them at the individual level.

An extremely important point must be clarified at this stage. The emphasis on distribution of income cannot be separated from establishing a vibrant and stable economy that can continuously provide plenty of earning opportunities to all who are in need. The failure of socialist and communist economies must be kept in mind. The solution lies in an economy where means of production could be held privately and the prices are generally allowed to be determined by the interaction of demand and supply. The degree of ownership of means of production through public enterprises should be linked to their relative efficiency and distributive considerations. But the primary and important role of the governments is implementing the commands of the Creator including an

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<sup>17</sup> *ibid*, p. 109.

Islāmically acceptable distribution of income pattern and maintaining an appropriate level of sustainable economic activities. One should not be shy if the solution retains some ideas, theories, practices and institutions developed by neoclassical microeconomics and neoclassical-Keynesian macroeconomics.

Another important point that needs to be emphasized is that capitalist countries have developed elaborate mechanism of taxes and transfers to address distributive concerns. While this mechanism should also be used (and could go beyond what could be achieved through *zakāh* funds collected at the traditional rate), stretching this instrument too far could be counterproductive. Islāmīc economists should be continuously looking for other possible avenues to improve the existing distribution of income pattern. The present paper is an attempt in this regard where a few such important avenues are discussed at a later stage.

M. Umer Chapra highlights the importance of individual responsibility in a free market system. He stresses the importance of an additional filter mechanism to assist the price system for a more desirable and equitable use of resources in the economy so that every member of the society could be assured of the basic needs of life. According to him:

"Allocation of resources is to be brought about by a double layer of filters. The first filter attacks the problem of unlimited wants at the very source ---- *the inner consciousness of individuals* --- by changing the individual's preference scale in keeping with the demands of both efficiency and equity. Islām makes it incumbent upon all Muslims to pass their potential claims on resources through the filter of Islāmīc values so that many of them are eliminated at the source before they are exposed to the second filter of market prices."<sup>18</sup> (my italics)

Chapra also argues for categorizing all goods and services into three groups: needs, luxuries and intermediates.<sup>19</sup> For the last category which consists of those goods which cannot be clearly classified as basic needs or luxury, Chapra suggests the imposition of high rate of taxes or tariffs to discourage their demand. He admits that in the contemporary Muslim societies conspicuous consumption has become a part of social frame of mind, and until individuals in Muslim societies stop consumption of luxury goods on a voluntary basis, it is imperative for the governments even to impose a ban on production or import of such goods.

<sup>18</sup> Chapra, M. Umer (1991), p. 34.

<sup>19</sup> Chapra (1992, PP.284-5)

Although, one can be only sympathetic with Chapra's concern for need fulfillment for all, his suggestions to achieve this goal may create some problems. For example, categorization of all goods and services into three groups would not be a small issue. Even if it can be made possible, if people have the means to spend as they desire, they would either try to get around the ban or find other avenues of expenditure. Also, what is deemed luxury by some people could be seen as a general requirement or even a necessity by the others.

A major part of the solution lies in improving the distribution of income in the economy so that everyone gets an income that is enough to satisfy his basic needs. Obviously, improvement in distribution of income that leads to an equitable state of affairs does not mean that no one in the society will be able to afford luxury goods. Significant differences in income would still exist and a section of people would be able to buy such goods and services that are seen luxury and / or unaffordable by others.

The demise of the socialist economies is a clear proof that the task of improving distribution of income pattern which at the same time remains efficient is not an easy task. However, for Islāmic economics to provide an alternative to capitalism or socialism, we have to accept that challenge.

Assuming that the understanding of the goals and objectives of an Islāmic economic system mentioned earlier are correct, the next question is how to achieve those goals? Should we completely part of the ways with the existing capitalist system and the neoclassical school that provides the intellectual background for its existence? Or should we have an agenda for reforming the existing capitalist system?

#### **4. Is Neoclassical School Totally Flawed and Utterly Useless?**

The criticisms of the contemporary capitalist system are many; not only Islāmic economics but the whole concept of heterodox economics is basically a critique of the orthodox economics that provides the intellectual and theoretical background for the mainstream economics also including the neoclassical economics. However, criticizing a system is one thing, and perhaps the easier part, providing alternative ideas and their practical corollaries is the other, and much more difficult. Moreover, the alternatives must be powerful and convincing enough to instigate a change. Before giving a critical review of neoclassical school, let me first emphasize that two of its fundamental axioms also have its place in the core of Islāmic economics.

#### **4.1 The Common Threads of Neoclassical Thoughts and Islāmic Economics**

Since its birth in the late nineteenth century, neoclassical school has been criticized by many individual economists belonging to different heterodox schools of thought. The fact that, not only it has not been dislodged so far, but it has remained the dominant school of thought, needs some serious contemplation. This school was born when Marshal synthesized the views of classical economists (to whom exchange value of a commodity was determined by its cost of production, the supply side consideration) and the marginalists' emphasis on the exclusive role of demand on exchange value. He was thus able to present the most important theory and tool for economic analysis; demand and supply – the exchange value axiom of the neoclassical school.

It has been used for explaining the market value or exchange value of goods and services. There are many critics of this tool including Asad Zaman. However, it has survived all criticisms, in my view, mainly because it is flexible enough to handle many different situations that can affect the shapes of the demand and/or supply curve. Also because there is some truth in the assumptions of diminishing marginal utility that produces a negatively sloped demand curve and that supply of many goods and services generally increases with increase in their prices all other things being unchanged. There exist anomalies in demand and supply framework, but by and large it has remained a useful tool in guiding allocation of resources in different sectors of the economy.

There are suggestions made by the Institutionalist school that exchange prices are not determined freely as claimed by the neoclassical school, rather are controlled through manipulation by powerful agents in an economy affecting the demand and/or supply. While this claim could be true (at least in some cases) it does not completely destroy the usefulness of demand and supply tool. Manipulation of demand and supply would affect the position of the demand and/or the supply curve but the analytical tool could still give insights into the prevailing exchange value or price of a commodity. Besides, there is no alternative tool that provides a better explanation of exchange values in market economies.

The demand and supply kit also explains, for example, how a government may use support prices for agricultural products to stabilize their prices for the benefit of all sections of the society. It also explains how different vested interests could use governments to arrange a favourable support price causing inefficiency and hurting consumers.

The neoclassical school continued to support (i) private ownership of means of production and (ii) its belief in the superiority of private sector's abilities in taking business initiatives. As it carries the legacy of classical economists, it remains sceptical about a government's ability in directly involving itself in economic activities both at the micro and the macro levels. We treat this as the second most important axiom of the neoclassical school.

Let us have a brief comment from an Islāmic perspective on the two axioms of the neoclassical school discussed above. Incidentally, the first axiom of the neoclassical school is also part of the basic principles of Islāmic economics. The contemporary Islāmic economic system would allow the markets to, by and large, work freely. Muslim societies have been practicing this since the time of the Prophet (pbuh), who clearly consented for prices to be determined through markets, i.e., with the interaction of demand and supply. The Prophet (pbuh) and later Muslim scholars emphasized to remove any unwanted and unnatural means such as hoarding and other practices that could hinder the fair play of demand and supply.<sup>20</sup>

It could be thus suggested that Islāmic economics should not reject the theory of (exchange) value of goods and services espoused by neoclassical school.<sup>21</sup> As mentioned above, the contribution of the neoclassical school in price theory and how prices are determined under different market structures is important even if there are some unresolved issues. For example, if there is a big difference between exchange value (partially determined by purchasing power) and the value of the good, then there is a case for government intervention especially to deal with essential

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<sup>20</sup> The holy Prophet said: "Verily, Allah (swt) determines the climate of economic affluence and gloom. I do not want to take any action to fix the prices because I do not want that, later in hereafter, any among you to demand for the return of your property and blood from me because of my tyranny (in fixing the prices)], Sunan Abū Dāwūd, *Kitāb al-ijārah*, vol.2, p 293. According to Ibn Taimiyah "Rise and fall in prices is not always due to injustice (zulm) of some people. Sometimes its reason is deficiency in production or decline in import of the goods in demand. .... The scarcity or abundance may not be caused by the action of any people; it may be due to a cause not involving any injustice or, sometimes, .... It is Allah the Almighty who creates desires in the hearts of people..."(Ibn Taimiyah, 1381, vol.8, p. 523).

<sup>21</sup> In late nineteenth century Austrian economist Von Weiser had raised the issue of exchange value and intrinsic value of a commodity; the former determined by the desire, usefulness of a commodity as well as the purchasing power of the person who wants to buy the commodity. On the other hand, the intrinsic value of a commodity is its ability to satisfy the desire of a person with no reference to her purchasing power.

commodities.<sup>22</sup> I would also like to emphasize that the difference between the two values could be minimized through a proper distribution of income in the economy that increases purchasing power of the lower sections of the people. Indeed, when it comes to the pricing of factors of production such as wage and rent, interest and profits, like some other heterodox economics, Islāmic economics can have serious differences with neoclassical economics.<sup>23</sup>

Coming to the second neoclassical axiom<sup>24</sup>, throughout Islāmic history, the sanctity of private property has remained non-controversial. The governments of Islāmic economies would be, however, much more involved at the macro level, than what has been generally suggested by the members of neoclassical school. In this respect, Islāmic principles will be closer to Keynes, Post Keynesians and the ideas espoused by the Institutionalists school. The State has been assigned the duty to make sure that the wealth is not concentrated among the few. But individuals are generally allowed to pursue their struggle for material welfare within the boundaries and the environment created by the Islāmic state in accordance with Islāmic economic teachings. One of the important parameters of such environment could be derived from *sūrah al-A'rāf* (7:31).

## 4.2 The Problematic Elements of Neoclassical School

Perhaps the most common and fundamental criticism of neoclassical school is directed towards its assumptions on behavioural norms of economic agents; selfish consumers maximize their utility derived from consumption of goods and leisure time while selfish businessmen maximize their utility by maximizing profits. It is being argued that people are not selfish and instead they do care about others. Some Muslim economists claim that the neoclassical assumption of homo-economicus is wrong and the study of Islāmic economics should replace this assumption by homo-Islamicus.<sup>25</sup>

As far as the issue of maximization is concerned, it can be claimed that this assumption is made for constructing elegant mathematical models for

<sup>22</sup> This point was made by von Wieser.

<sup>23</sup> For my views on this topic, please see my paper, "Factors of Production and Factor Returns Under Political Economy of Islām", Journal of King AbdulAziz University: Islāmic Economics, (Vol. VIII, 1996), pp. 3-28.

<sup>24</sup> As stated in above paragraphs, the first axiom referred to neoclassical school's preference for market determined prices and the second, (i) the desirability of private ownership of means of production and (ii) the superiority of private sector's abilities in taking business initiatives.

<sup>25</sup> For example, see the views of Akram Khan in Siddiqui (2000; 7-8).

partial and general equilibrium analyses. These models do give some insights in understanding the working of different sectors of the economy. Their usefulness should neither be exaggerated nor utterly rejected.

Let us turn to the more crucial issue. Siddiqui (2000) emphasized the importance of distinguishing between selfishness and being self-interested. A businessman in Dubai imports food from India and supplies the same to supermarkets – to make a profit. This is an act in his self-interest and cannot be condemned from an Islāmic point of view. The same businessman can import outdated food, change the expiry dates and can make even higher profits – a selfish act. Adam Smith had proposed that if self-interested people are allowed to pursue their economic goals in a free market environment, it would not only benefit them but also (unintentionally) the society at large. This proposal did not mean that people are necessarily selfish and that they don't care about others. The observations made by two contemporary economists on this issue are very important.

Irving Kristol points out that Adam Smith never conceived of the economic man of capitalism as a whole man, but only a man-in-the-marketplace. He never celebrated self-interest, *per se*, as a human motive. He merely pointed to its utility in a population that wished to improve its condition which was to him a normal and universal human desire. For Adam Smith, sympathy was as natural a human instinct as self-interest, and on the whole more powerful.<sup>26</sup> Smith never disavowed his larger view of human nature presented in *The Theory of Moral Sentiments*, which was published well before *The Wealth of Nations*.

On the other hand, Allen Oakley claims that Smith had come to realize that outside the immediate family group, self-interest was a dominant influence for human action. However, as societies did not explode into Hobbesian ego driven chaos, it was equally evident that some sympathetic sentiment must be keeping people from destroying each other in the struggle to maximize returns to their ego.<sup>27</sup>

As far as the economy was concerned, Smith had less faith either in benevolence or in government intervention to restrain the excesses of self-interest and its transformation into selfishness. He particularly thought that businessmen often conspire against consumers. He thus relied more on competition among economic agents to produce harmony of interest in the society. His opposition to the mercantilist doctrine was due to their

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<sup>26</sup> Bell and Kristol (1981), p. 206.

<sup>27</sup> Oakley (1994), p. 114.

support for restricted markets and monopoly powers through the governments.

Some Islāmic economists would suggest that a model of Islāmic economic system should assume that producers and traders would be cooperating with each other and also be sympathetic to consumers. In my view, when we develop a model of Islāmic economic system we should avoid to assume that Muslim individuals in their roles of consumers and businessmen go to the market places primarily for altruistic motives. It is quite appropriate to assume a primarily self-interested behaviour by the consumers and businessmen at the market place. In no way this assumption should mean a generally selfish behaviour either by the consumers or the producers. We should also not share Smith's faith in free markets for creating harmony of interest among different groups in the economy; moral persuasion, appropriate policies and regulatory regimes will be necessary to achieve that goal.

The legacy of classical school for not allowing governments to intervene in the economy was carried forward by the neoclassical school. Irving Kristol has lamented out how economics after Smith, in its pursuit of becoming something like physical science, did not remain humanistic. For example, the common sense understanding that a marginal increase in the income of the rich represents less satisfaction than a comparable marginal increase to the income of the poor, has no scientific basis in modern economic theory and one has to import a philosophical-egalitarian bias into economics to legitimize them.<sup>28</sup>

The neoclassical school's continued emphasis on government non-intervention in troubling economies could not survive long periods of recessions. Keynes onslaught backed by meticulous theoretical work eventually destroyed that legacy in 1930s and saw decades of government activism through its fiscal and monetary policies. Finally, after they both retreated from their initial positions, the neoclassical-Keynesian synthesis emerged during the seventh decade of 20<sup>th</sup> century and still rules most of the macroeconomics text books.

Indeed neoclassical school may have its shortcomings especially if we look at it from an Islāmic perspective. The most fundamental criticism is its refusal to consider distributional and ethical issues and treating economics as a positive science. Asad Zaman (2012) gives an excellent account of this criticism.

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<sup>28</sup> *ibid.*, p. 115.



Neoclassical theory of interest that was originally presented by members of marginalist school was rejected by Marx and his followers but Keynes, along with his arguments in favour of government active role in the economy, wanted to eliminate interest during the next few generations.<sup>29</sup> However, Keynes' followers were unable to push for this goal and for an Islāmic economic system it will remain a vital issue. In my view, Islāmic economics looks at the issue of interest *primarily* from religious and moral ground; something the neoclassical school in principle are not ready to consider. Similarly, the theory of wage has been criticized by Institutionalists, Post Keynesians and most importantly by neo-Ricardians. Islāmic economics standing on this issue is not clear and a position on this vital issue could be formulated partially by looking at these heterodox positions.<sup>30</sup>

Another crucial shortcoming of neoclassical school is its treatment of land value and rent. It again arises from its un-readiness to include distributional aspects into economic analysis. The issue was most forcefully raised by Henry George in late 19<sup>th</sup> century in USA. George advanced the idea of land rent as unearned income initially hinted by Smith and Ricardo. While the classical economists did not suggest taking away that unearned income, Marx wanted to have public control of all the land in a country.

George proposed that while land should be owned by private individuals and businesses, all the increases in rents should be taxed away by the government. His idea was based on moral ground; increases in the value of land and its rent increases because of increase in population and growth in economic activities. Hence, the benefits of that increase should go to the society as a whole rather than those who own the land. This view, in my opinion, is not very far from the ethical teachings of Islām.

George had claimed that this single tax of land would generate such a voluminous amount of revenue that no other tax would be needed for all kinds of government expenditure freeing workers, capitalists and entrepreneurs from the burden of taxes. Although his book *Progress and Poverty* was a best seller of his time and sold millions of copies, his lack of emphasis on empirical data, his soft stand on capitalists and interest, stress on a single tax and presence of powerful lobbies against him did not let him succeed.

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<sup>29</sup> General Theory (Chapter 24).

<sup>30</sup> For a discussion on this issue please see Siddiqui (1997-98).

Asad Zaman, perhaps the most prominent econometrician and mathematician among Islāmic economists, has pointed out the excessive use of maths by neoclassical school.<sup>31</sup> This has been the criticism by all heterodox school, most notably the ultra-liberal school of economics, the Austrian school. Apart from the use of mathematical models and principles, the Austrians also criticize the orthodox school for their lack of a proper theory of entrepreneurship as well as their excessive emphasis on equilibrium analyses rather than the dynamic economic processes.

From an Islāmic economics perspective, the role and behaviour of entrepreneurs is also very significant. The Austrians emphasize the role of entrepreneurs in their abilities to locate existing profit opportunities but also in creating profit opportunities with their far-sightedness. For Schumpeter, they are the real engines of growth and prosperity. Islāmic economists have not put enough efforts in this area inspite of the fact that the role of entrepreneurs is crucial in an Islāmic economic system. Entrepreneurs not only start new businesses and expand existing ones, but they also employ capital, labour and produce goods and services. Their control and treatment of labour, dealings with capitalists on profit and loss sharing, their care and responsibilities towards consumers and the society at large, their consideration for environmental degradation, their willingness to honestly pay their dues to the governments – all these make them perhaps the most crucial players of an Islāmic economy. The ethical orientation of entrepreneurs is not something emphasized by the Austrians.

The main emphasis of Keynes' *General Theory* was the role of money and interest on investment, and government intervention through fiscal and monetary policies. But he also wrote on one of the other pillars of capitalist financial system - stock markets. For example:

Chapter 12, Section V:

Of the maxims of orthodox finance none, surely, is more anti-social than the fetish of liquidity, the doctrine that it is a positive virtue on the part of investment institutions to concentrate their resources upon the holding of "liquid" securities. It forgets that there is no such thing as liquidity of investment for the community as a whole. The social object of skilled investment should be to defeat the dark forces of time and ignorance which envelop our future.

This battle of wits to anticipate the basis of conventional valuation a few months hence, rather than the prospective yield of an investment over a long term of years...For it is, so to speak, a game of Snap, of

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<sup>31</sup> Zaman (2012).

Old Maid, of Musical Chairs - a pastime in which he is victor who says Snap neither too soon or too late, who passes the Old Maid to his neighbor before the game is over, who secures for himself when the music stops.

#### Chapter 12, Footnote 5:

It is said that, when Wall Street is active, at least half of the purchases or sales of investments are entered upon with an intention on the part of the speculator to reverse them the same day. This is often true of the commodity exchanges also.

#### Chapter 12, Section VI

Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done. The measure of success attained by Wall Street, regarded as an institution of which the proper social purpose is to direct new investment into the most profitable channels in terms of future yield, cannot be claimed as one of the outstanding triumphs of Laissez faire - capitalism – which is not surprising, if I am right in thinking that the best brains of Wall Street have been in fact directed towards a different object. These tendencies are a scarcely avoidable outcome of our having successfully organized “liquid” investment markets. It is usually agreed that casinos should, in the public interest, be inaccessible and expensive...The introduction of a substantial Government transfer tax on all [stock market] transactions might prove the most serviceable reform available, with a view to mitigating the predominance of speculation over enterprise in the United States.

The spectacle of modern investment markets has sometimes moved me towards the conclusion that to make the purchase of an investment permanent and indissoluble, like marriage, except by reason of death or other grave cause, might be a useful remedy for our contemporary evils.

It can be imagined how Keynes would have reacted on the current level of speculative activities in financial markets and the growth of financial derivatives as at present. Again for an Islāmic financial system in which activities involving *maīsir* must be controlled, such financial products and the institutions facilitating their trade should be thoroughly scrutinized.

Another area where the theories of neoclassical school have not been quite successful is the mechanism of international payments and the

corresponding exchange rate regimes. While the gold standard system might have been unsustainable, the world has been long waiting to see a better workable alternative than the current arrangement. Apart from some highly developed countries, very few are willing to follow the neoclassical prescription of letting their currencies completely at the mercy of free markets. This area too requires a thorough investigation by Islāmic economists.

## 5. Causes of Failure of Islāmic Economics and Some Suggested Remedies

In last two sections, the author described his understanding of the goals and objectives of Islāmic economics and the strength and shortcomings of the neoclassical school. This has also indirectly shed some light on the cause of failure of Islāmic economics and finance. Most writings by Islāmic economists and other Islāmic scholars who wrote on economic issues did not come up with concrete proposals of reforms that could have significant effects on distribution of income or instigate meaningful changes in capitalist institutions. We have been unable to produce the required literature that could seriously challenge the current orthodoxy in economics. The existing Islāmic economics literature has failed to produce any significant impact on sceptical economists in the Muslim world and the Muslim masses in general.

The largest volume of work in Islāmic economics and finance has been on Islāmic banking and finance. Also, this is the only sector of economy in Muslim countries where some Islāmic injunctions pertaining to economics have witnessed some implementation. But what has been the result? Without doubt, there has been phenomenal growth in the number of Islāmic banks and their deposits, *takāful* companies and markets for *ṣukūk*. However, the *fiqh* scholars of these institutions were mainly concerned about the legality of a product in light of the verdicts of past *fuqahā'* and their own interpretations for validating the contemporary products. Apparently, their methodology lacked proper concern for bringing in interest from the back door, transparency, distributive justice or undesirable outcome such as consumerism and extravagance unleashed through certain products of Islāmic banks.

The most fundamental flaw in this respect, in view of this author, was the acceptance of *bai' bithamin 'ajil* (with higher than current price) by Muslim economists which has paved the way for the use of conventional banking products with Arabic names – all other things being (almost) unchanged. This acceptance has been made possible through reference to

non-unanimous *fiqhī* verdicts and without any consideration of distributive justice and contemporary realities. This is fundamentally a flaw of methodology adopted by many Islāmic economists and Islāmic scholars writing on economic issues where *fiqhī* verdicts of the past become the yard stick for allowing, disallowing or suggesting an economic activity even if those verdicts happened to be disputed or nonaligned with *maqāṣid al-Sharī'ah*. It can be construed that Islāmic economists either agree with the dominant religious verdicts or, may be, they lack proper religious credentials or courage to oppose them.<sup>32</sup>

Islāmic economists have shown how the entire financial sector of an economy can significantly change the nature of banking and finance if the original idea of profit and loss sharing Islāmic banking (PALSIB) was introduced. Siddiqui (2010) discusses at length the need for establishing PALSIB and the necessary steps that need to be taken to accomplish a job that requires much more concerted and prolong efforts than what we may ordinarily think. The paper also advocates for the establishment of special institutions for zero interest loans for consumer durables as well as for reforming the stocks markets to make them markets for dividends instead of a place for seeking quick capital gains. It also suggests changes in the role of central banks.

Islāmic economists, in general, have not argued for land reforms and as a group they have followed the dominant *fiqhī* view that does not permit ceiling on agricultural land holdings often acquired as a gift for supporting colonial or illegitimate domestic powers. Similarly, Islāmic economists seldom write on labour issues or taxation on capital gains on land and other assets - issues that have significant implications for distribution of income. Thus, as far as land and labour issues are concerned, one can agree with Asad Zaman that Islāmic economists are not different from neoclassical school. However, the reason is not that Islāmic economists accept economics as a positive science (as Zaman suggests) but it is their flawed methodology of following the past *fuqahā'* without evaluating them especially in the light of contemporary realities.

In my view, the Georgian suggestions on land value tax or capital gains tax on land should be seriously studied to curb unproductive speculative activities (avoiding *maīsir*), improve efficiency in land use, and to facilitate a better distribution of income pattern.

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<sup>32</sup> As far as I'm concerned, I have not found the arguments given in favour of *bai' bithamin 'ajil* (with higher than current price) convincing.

Islāmic economists have also not given enough time and thought on issues related to labour and wages nor have they discussed the role of entrepreneurs in an Islāmic economic system. Apparently they have accepted the position of the neoclassical school on the roles of these two factors of production and the way their remunerations are determined. A clearer Islāmic position on these issues is required after closely evaluating the neoclassical views as well as the criticisms made by different heterodox schools.

### **On Asad Zaman's Proposal**

Asad Zaman, like some other Islāmic economists, finds the basic reasons for failure of Islāmic economics in accepting the behavioural assumptions of neoclassical economics – that human beings as consumers and producers are primarily selfish and greedy and as producers they compete with each other. Muslims are supposed to care about themselves and their families but they are also required to be concerned about others. As producers they are supposed to cooperate rather than compete. It is accepted that at present Muslim individuals are not attempting to reach the ideal behaviour, and hence one cannot assume that they are more caring than selfish, more inclined to cooperate than compete.<sup>33</sup>

The solution, according to Zaman lies in putting all our efforts, as Islāmic economists, in educating masses to struggle for adopting the Islāmic behaviour. That is the only way one can achieve the goals of Islāmic economics which is, to establish the commands of God in the economic sphere.<sup>34</sup>

Although not explicitly said by Asad Zaman, he thinks if his prescription is implemented, there will be no need for a government and its various agencies to solve economic problems. Nowhere in his writings, he has given any idea about the role of the government in the economy. It will not be too far-fetched to claim that, in his view, government and its agencies cannot be helpful in solving economic problems and hence should not be relied upon or there is no need/role of a government in his strategic plan for establishing an Islāmic economy.

It is difficult to agree with Asad Zaman's proposal, and quite contrary to what has been suggested in this paper, as members of Muslim community, Islāmic economists along with other relevant members of the society should not leave any opportunity to teach and preach and be good

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<sup>33</sup> Zaman (2012)

<sup>34</sup> *Ibid.*

examples of Islāmic behaviour in the market place. However, this is neither the primary nor the only responsibility of Islāmic economists. Also, it is difficult to imagine that the number of people behaving ideally will rise and remain to such a high level that the role of the government and its agencies in systematic organization of the economy on Islāmic principle will become superfluous. It does not mean that Muslim societies are empty of generous people. Far from that, even in poor countries like Pakistan hundreds and thousands individuals and local organizations are giving their time and wealth to help poor and in almost all cases they are far more efficient than any government departments created for such purpose. But Islāmic economics is not only about organization of charity and alms giving, its main task is to help organizing an economy where each person looking for livelihood is able to find a suitable solution, and harmony among different factors of production is achieved through economic justice based on Islāmic principles. Can this task be completed without the help of the government and its agencies?

At present, it is appropriate to assume that most people, for the most part, act in their *self-interest* in the *market place* (which does not necessarily imply greediness or selfishness on their part).<sup>35</sup> Similarly, we cannot make the assumption that Muslim producers, in general, voluntarily cooperate among themselves for the benefit of the society (rather than compete among themselves to gain more and more clientele or profits). By and large they do try to compete with each other through costs and price cuts and better product and services which actually go in favour of ordinary individuals in the society. Indeed they also wage war of (excessive) advertisement, apparently a waste of resources. For such kinds of acts we may need proper government intervention if it improves overall efficiency rather than creating new avenues of corruption and / or mismanagement.

Being economists, Islāmic economists have the daunting task of presenting the details of a system of production and exchange and related institutions, rules and regulations that (a) *incorporate* Islāmic economic principles and (b) *help* individual Muslims behave according to the teachings of Islām through creation of appropriate levels of economic activities and distributive justice.

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<sup>35</sup> For a detail treatment of this issue please see this author's paper, "A suggested Methodology for the Political Economy of Islām", *Journal of King AbdulAziz University: Islāmic Economics* (Volume XII, 2000), pp. 3-27.

## 6. Marketing & Popularizing Islāmic Economics

Economists, primarily based on their understanding of economics have their preferences for certain political parties and / or their economic policies. For example, economists belonging to neoclassical and Austrian schools of thought have generally supported the Conservative party in UK and the Republicans in the United States. On the other hand the Keynesians and Post Keynesians generally support Labour party and the Democratic party respectively. It is obvious that economic policies can only be adopted through the political parties in a democratic system. Some economists also write newspaper and magazine articles and take part in TV programmes on economics to influence the public officials and the masses in general.

Islāmic economists should also take a proactive role in disseminating their views through every possible channel. Even in countries where political parties do not function, efforts should be made to publicize the features and potential benefits of an Islāmic economic system to government officials as well as the general public. In this age of a vibrant internet and social media, there are innumerable ways to influence public opinion.

It is also important that Islāmic economists take a more non-partisan approach and do not seem to be favouring a particular group. At this stage everyone should be approached to provide the necessary information about the desirability as well as the feasibility of Islāmic economic system. For example, in Pakistan, Islāmic economists should not rely entirely (or even largely) on religious political parties. With a detailed proposal for Islāmic economic reforms, new rules and regulations and new institutions, all major and minor political forces should be approached. On the other hand a continuous effort should be made to convince religious scholars of different schools of thought to rethink their century old positions inherited from past *fuqahā'* (such as on distribution of land) as long as the revised position conforms to the spirit of the Qur'ānic teachings.

## 7. Concluding Remarks

Like heterodox schools, Islāmic economics is critical of neoclassical school and the contemporary capitalist system. However, the current literature on Islāmic economics and finance either lacks to present a credible alternative or has failed to convince sceptical economists and the general masses of the Muslim world; perhaps both. This paper points out some of the possible reasons for this situation and provides a few suggestions for future efforts.



It has been argued that despite a number of criticisms against the neoclassical school, its primary premise of a free market environment and permissibility of private ownership of means of production are also an important aspect of an Islāmic economic system. On the other hand its assumption of self-interested behaviour of economic agents should be seen in a more appropriate perspective.

The basic criticism of neoclassical school should be directed towards its aversion to give distribution of income the right priority it deserves from Islāmic perspective. The goal of an Islāmic economic system is to implement the commands of our Creator and provide an economic environment that is conducive for following the teachings of Islām at individual and collective levels. With just distribution of income and proper institutions, the society can go a long way to achieve both these goals. An economy that provides appropriate earning opportunities to everyone in need and where continuous efforts are made for equitable distribution of newly created income and wealth to different factors of production, can help its individuals in curbing undesirable natural instincts such as jealousy as hatred.

It could be suggested that the governments of Muslim countries, apart from creating a conducive environment for an appropriate level of sustained economic activities, should be looking into the means and ways to introduce:

1. A truly profit and loss sharing financial system so that<sup>36</sup>
  - i. when the economy performs well, all parties (providers of investable funds, financial intermediaries & users of the funds) in the system benefit and when it slows down, all share the burden accordingly;
  - ii. the depositors of the banks are treated as investors and on average their rate of return is considerably higher than what they get now (in many developing Muslim countries even less than the inflation rate) as the banks earn profits from their business;
  - iii. a system of interest free loans for consumer durables and small businesses is established;

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<sup>36</sup> A detail outline for establishing a PLS Islāmic banking system that includes the above points could be found in Siddiqui (2010). Siddiqui (1996) provides some suggestions for land reforms and governments' support for workers. supporting the

- iv. controlling the inflation becomes the primary job of the central bank which also offers necessary liquidity to Islāmic banks on PLS basis and provides guidance on profit and loss sharing ratios between banks, fund providers and funds users.
2. Capital gains tax on land value so that (a) the income thus generated goes to the society as a whole rather than to the land lords, and (b) speculative investments in land are discouraged.
3. Land reforms in the agricultural sector and guidelines for land ownership and land utilization in urban areas.
4. Labour market reforms favouring workers through fixing minimum wages, job security and other rules and regulations with regard to work and commensurate reward in such a way that their 'basic' needs are fulfilled, at the least.

The suggestions given above are neither exhaustive nor complete actionable steps are provided for implementing them. The efforts of Islāmic economists should be directed towards providing the relevant literature as well as detail policies in each of these areas.

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