

ESSENTIAL PERSPECTIVES IN ISLAMIC ECONOMICS AND FINANCE

Islamic Economic Methodology

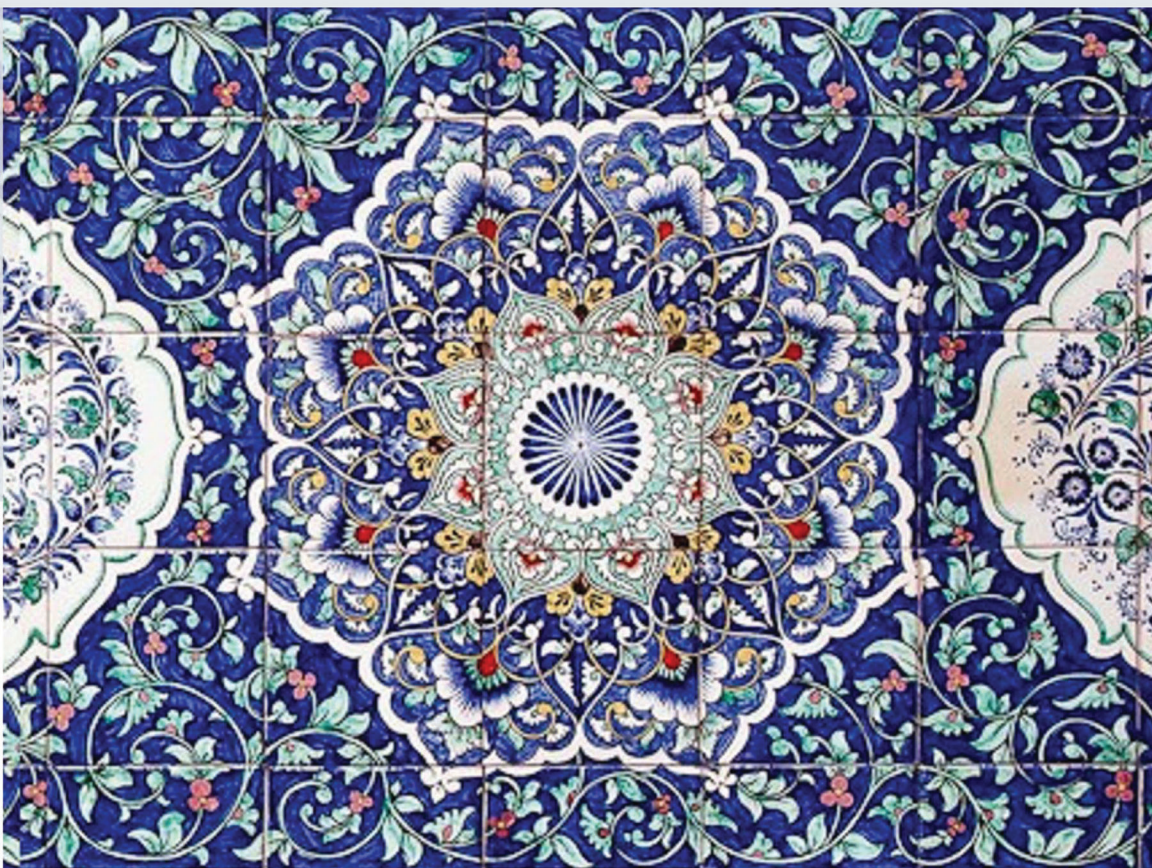
Islamic Economic Concepts

Islamic Economic Policy

Islamic Banking Operation

Islamic Capital Market

Zakat and Waqf



Edited by

Haniza Khalid

Mohd Nizam Barom

Nasim Shah Shirazi

ESSENTIAL PERSPECTIVES IN ISLAMIC ECONOMICS AND FINANCE

Edited by

Haniza Khalid, Mohd Nizam Barom and Nasim Shah Shirazi



Kulliyah of Economics and Management Sciences
International Islamic University Malaysia



Islamic Research and Training Institute
A member of the Islamic Development Bank Group

© 2016 Kulliyah of Economics and Management Sciences, IIUM
International Institute of Islamic Thought

ISBN 978-983-44368-1-8

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise without the prior permission of the publisher.

Jointly published by
Kulliyah of Economics and Management Sciences
International Islamic University Malaysia (IIUM)
Jalan Gombak, 53100 Kuala Lumpur, Malaysia

Islamic Research and Training Institute (IRTI)
@Islamic Development Bank
8111 Al Nuzlah Al Yamaneyyah 2444,
Jeddah, Saudi Arabia 22332

Printed in Malaysia

Contents

Contributors	ix
Preface	xiii
Foreword	xv
Chapter 1	1
Essential Perspectives in Islamic Economics and Finance: An Introduction	
<i>Haniza Khalid, Mohd Nizam Barom and Nasim Shah Shirazi</i>	
Part I: Islamic Economic Methodology	
Chapter 2	27
Preliminary Thoughts on Diagnosing Some Methodological Issues in Developing Islamic Economics	
<i>Mohamed Aslam Haneef</i>	
Chapter 3	49
Logical Positivism and Islamic Economics	
<i>Asad Zaman</i>	
Part II: Islamic Economic Concepts	
Chapter 4	85
A Comparison of Islamic and Capitalist Conception of Islamic Justice	
<i>Omar Javaid and Mehboob ul Hassan</i>	

Chapter 5	118
Sustainable Islamic Development: Recognizing the Primacy of Trust, Iman and Institutions <i>Nazim Zaman</i>	
Chapter 6	139
Conceptualizing a Strategic Framework of Social Responsibility in Islamic Economics <i>Mohd Nizam Barom</i>	
Part III: Islamic Economic Policy	
Chapter 7	175
Fiscal and Monetary Policies in Islamic Economics: Contours of an Institutional Framework <i>Sayyid Tahir</i>	
Chapter 8	201
Riba, Profit Rate, Islamic Rate, and Market Equilibrium <i>Mohammed Bin Yusoff</i>	
Chapter 9	232
Inflation and Monetary Policy in an Islamic Financial System: Empirical Relationships Among Money, Output and Consumer Prices in Nine Muslim-Majority Countries <i>Akhand Akhtar Hossain</i>	
Chapter 10	285
Monetary Systems, Sustainable Growth and Inclusive Economic Development <i>Edo Omercevic</i>	
Part IV: Islamic Banking Operation	
Chapter 11	317
Conceptualizing Illusion: Theoretical Illustration of Truth and False in Epistemological Methodology Followed in Islamic Finance <i>Mohammad Bin Abdul Rahim Alsaghir</i>	

Chapter 12	349
Towards an Integrated Theory of al-Maqasid: The UM-HI Framework and Its Application in Islamic Banking and Finance <i>Mustafa Omar Mohammed</i>	
Chapter 13	371
Qard Hasan: Its Shariah Rules and Applications in Islamic Finance <i>Syed Faiq Najeeb and Ahcene Lahsasna</i>	
Part V: Islamic Capital Market	
Chapter 14	397
Screening Strategies for Social Responsibility Concern in Islamic Equity Investment <i>Mohd Nizam Barom</i>	
Chapter 15	421
Sukuk Market Development and Behaviour in Times of Crisis <i>Maya Puspa Abd Rahman, Mohd Azmi Omar and Salina Kassim</i>	
Chapter 16	454
Applications of Shariah compliant derivatives for Hedging Exchange Rate Risks in Islamic Finance <i>Zaharuddin Abd Rahman</i>	
Part VI: Zakat and Waqf	
Chapter 17	485
Integrating Zakāt and Waqf into the Poverty Reduction Strategy of the IDB Member Countries <i>Nasim Shah Shirazi</i>	

Chapter 18	542
Issues and Challenges in Enhancing the Efficiency of Waqf Institutions: The Case of Selected Waqf Institutions in Malaysia <i>Norma Md Saad, Salina Kassim and Zarinah Hamid</i>	
Chapter 19	559
Corporate Waqf and its Role in Financing Different Needs: Case Studies in Turkey, India, Pakistan and Malaysia <i>Magda Ismail Abdel Mohsin</i>	

Contributors

Mohamed Aslam Haneef

Professor,
Department of Economics and
Director,
Centre for Islamic Economics,
International Islamic University
Malaysia,
Kuala Lumpur, Malaysia.

Asad Zaman

Vice Chancellor,
Pakistan Institute of Development
Economics,
Islamabad, Pakistan.

Omar Javaid

Senior Lecturer,
Management and HRM
Department, Institute of Business
Management,
Karangi Creek,
Karachi, Pakistan.

Mehboob ul Hassan

Professor and Chair of Islamic
Banking,
King Saud University,
Riyadh, Saudi Arabia

Nazim Zaman

Assistant Professor,
College of Islamic Economics and
Finance,
Umm Al-Qura University,
Makkah, Saudi Arabia.

Mohd Nizam Barom

Assistant Professor,
Department of Economics and
Research and Publication
Coordinator,
Centre for Islamic Economics,
Kulliyah of Economics and
Management Sciences,
International Islamic University
Malaysia,
Kuala Lumpur, Malaysia.

Sayyid Tahir

Professor,
Department of Economics and
Research Fellow,
Centre for Islamic Economics,
Kulliyah of Economics and
Management Sciences,
International Islamic University
Malaysia,
Kuala Lumpur, Malaysia.

Mohammed B. Yusoff

Professor,
Department of Economics,
Kulliyah of Economics and
Management Sciences,
International Islamic University
Malaysia
Kuala Lumpur, Malaysia.

Akhand Akhtar Hossain

Associate Professor,
Newcastle Business School,
University of Newcastle,
Callaghan, Australia.

Edo Omerčević

Director,
Center for Advancement of Free
Enterprise,
Zenica, Bosnia and Herzegovina.

Mohammad Bin Abdul Rahim**Alsaghir**

School of Government and
International Affairs,
University of Durham,
Durham, United Kingdom.

Mustafa Omar Mohammed

Associate Professor,
Department of Economics and
International Collaboration
Coordinator,
Centre for Islamic Economics,
Kulliyah of Economics and
Management Sciences,
International Islamic University
Malaysia,
Kuala Lumpur, Malaysia.

Syed Faiq Najeeb

Financial Sector Specialist,
Islamic Financial Services Board
(IFSB),
Kuala Lumpur, Malaysia.

Ahcene Lahsasna

Associate Professor and Deputy
Director,
Centre of Research and Publication,
International Centre for Education
in Islamic Finance (INCEIF)
Kuala Lumpur, Malaysia.

Maya Puspa Abd Rahman

Assistant Professor,
Department of Economics and
Research Fellow,
Centre for Islamic Economics
Kulliyah of Economics and
Management Sciences,
International Islamic University
Malaysia
Kuala Lumpur, Malaysia.

Mohd Azmi Omar

Director General,
Islamic Research and Training
Institute (IRTI),
Jeddah, Kingdom of Saudi Arabia.

Salina Kassim

Associate Professor,
Institute of Islamic Banking and
Finance
International Islamic University
Malaysia,
Kuala Lumpur, Malaysia.

Zaharuddin Abd Rahman

Assistant Professor,
Department of Economics,
Kulliyah of Economics and
Management Sciences,
International Islamic University
Malaysia
Kuala Lumpur, Malaysia.

Nasim Shah Shirazi

Senior Research Economist,
Islamic Research and Training
Institute (IRTI),
Jeddah, Kingdom of Saudi Arabia.

Norma Md Saad

Professor,
Department of Economics and
Research Fellow,
Centre for Islamic Economics,
Kulliyah of Economics and
Management Sciences,
International Islamic University
Malaysia,
Kuala Lumpur, Malaysia.

Zarinah Hamid

Professor,
Department of Economics,
Kulliyah of Economics and
Management Sciences,
International Islamic University
Malaysia,
Kuala Lumpur, Malaysia.

Magda Ismail Abdel Mohsin

Associate Professor,
International Centre for Education
in Islamic Finance (INCEIF),
Kuala Lumpur, Malaysia.

Haniza Khalid

Assistant Professor,
Department of Economics,
Kulliyah of Economics and
Management Sciences,
International Islamic University
Malaysia,
Kuala Lumpur, Malaysia.

Part I

Islamic Economic Methodology

Chapter 2
Preliminary Thoughts on Diagnosing Some Methodological
Issues in Developing Islamic Economics
Mohamed Aslam Haneef

Chapter 3
Logical Positivism and Islamic Economics
Asad Zaman

Preliminary Thoughts on Diagnosing Some Methodological Issues in Developing Islamic Economics¹

Mohamed Aslam Haneef

ROBERT LUCAS, one of the greatest macroeconomists of his generation, and his followers are “making ancient and basic analytical errors all over the place”. Harvard’s Robert Barro, another towering figure in the discipline, is “making truly boneheaded arguments”. The past 30 years of macroeconomics training at American and British universities were a “costly waste of time”. To the uninitiated, economics has always been a dismal science. But all these attacks come from within the guild: from Brad DeLong of the University of California, Berkeley; Paul Krugman of Princeton and the New York Times; and Willem Buiter of the London School of Economics (LSE), respectively. The macroeconomic crisis of the past two years is also provoking a crisis of confidence in macroeconomics. In the last of his Lionel Robbins lectures at the LSE on June 10th, Mr Krugman feared that most macroeconomics of the past 30 years was “spectacularly useless at best, and positively harmful at worst”. These internal critics argue that

economists missed the origins of the crisis; failed to appreciate its worst symptoms; and cannot now agree about the cure. In other words, economists misread the economy on the way up, misread it on the way down and now mistake the right way out.

Economist July 16 2009

Our dissatisfaction with the explanatory power and logical consistency of neo-classical economics has exercised our minds for the best part of two decades, and the discourse that follows has been refined over countless morning tea discussions, dinner conversations and email exchanges. There is no question that this paper is long overdue, and we have had to nurse our consciences having not attempted, before now, to fulfil our social responsibility as academics to persuade others in their scientific community of our views. The simple fact of the matter, however, is that a range of obstacles have been in existence that would have rendered ineffective any attempt to proffer alternative views in any case. Now things are different, and one of the objectives of this article is to elaborate on this theme, and explain why circumstances have contrived to make this paper a reality.

Williams and McNeil (2005).

1. Introduction: Is Islamic Economics in 'Crisis'?

Before we attempt an answer, let us briefly take a look at the word itself. Generally the word brings these three inter-related meanings

1. a time of intense difficulty or danger
2. a time when a difficult or important decision must be made
3. the turning point (of a disease) when an important change takes place, indicating either recovery or death.

These three inter-related meanings for Islamic Economics would

be represented by the following statement ‘Islamic Economics is in a state of crisis because we are in intense difficulty and are in danger (of ‘dying’), hence we must make a decision that will take us to recovery (if we make the right decision)’. Hence we need to identify

4. what is the intense difficulty/danger we are facing (if it is a crisis)
5. what is the nature of the ‘intense difficulty’ (and is it the same danger faced by modern economics)
6. what are the grave implications of the crisis
7. why are we in this situation
8. what are our options
9. what decision do we make
10. which option do we take and why
11. is there only one option or can there be more than one
12. what to do and how to do it

The above questions need to be kept in mind by all Islamic economists when deliberating on the future direction to be taken. There should not be any hesitation to be critical or to discuss sensitive issues and topics as the overall intention is to take the discipline forward. It should also be kept in mind that which path we take will have implications not only on the direction of Islamic economics (if we choose something different), but will also have ripple effects on other related areas such as Islamic Banking and Finance.

1.1 Crisis in Modern Neoclassical Economics: Challenge and Opportunity for Islamic Economics

As the two quotations at the beginning of the paper show, much has, and can be written on this topic. Soul searching is definitely taking place and that is one of the lessons we learn from Chinese wisdom that sees ‘opportunities in times of crisis’. In essence the main difficulties being faced by modern neoclassical economics is that it is increasingly being seen as being ‘autistic’ or deficient since it is not able to explain reality; it overuses and abuses mathematics and

statistics; it has not been able to solve real problems, and in fact is being blamed for aiding in manifestations of problems faced by the majority of the people; and that in general it has become 'out-dated', teaching theories that have been disowned by their authors as well as being based on unrealistic assumptions.

Is Islamic economics 'as developed over the last 40 years or so', also 'autistic' in the same way? Is Islamic economics able to explain human behaviour, able to solve the economic problems of the people, has it abused mathematics and is it 'out-dated'? I do not think sufficient attention has been paid to these questions by Islamic economists as a whole. These questions by themselves would make an interesting Masters, if not PhD thesis.

While the critics of modern neoclassical economics point to solutions in the writings of other non-neoclassical scholars such as Keynes or even want to promote ideas of other heterodox schools, Islamic economists who agree that there is 'something wrong' with contemporary Islamic economics say that we have to 'go back to our religion and its sources', implying that contemporary, mainstream Islamic economics has not correctly developed the discipline, being happy to make minor modifications to modern neoclassical economics (Zaman, 2012).² Just as defenders of modern neoclassical economics would disagree with the propositions of 'going back to Keynes', many supporters of contemporary mainstream Islamic economics would think that the critics of Islamic Economics are too harsh.

The nature of the problems in Islamic economics are not the same as diagnosed for mainstream neoclassical economics. One 'group' of criticisms that can be identified in the literature are the problems related to the 'replication' argument, *i.e.* Islamic economics has not broken out of the neoclassical mould. However, the nature and extent of problems in IE is certainly not the same as in modern neoclassical economics. Islamic economics did not cause the problems of today; it has not really 'misused and abused math', as can be seen from the literature over the last 40 years. It may have prematurely

claimed that it provided solutions to some problems; its own 'mainstream version may be guilty of teaching outdated theories that do not reflect realities of the day. However, the main criticism of Islamic economics is that it has not become a discipline yet.

Islamic economics does not seem to be moving forward. It seems to be stagnating. If in the late 1960s and 1970s to early 1980s, the ideas were 'fresh' and inspiring, developments of those ideas into theories did not take place; new ideas did not flourish and too much focus has been given to Islamic Banking and Finance. Hence, the crisis occurring in modern neoclassical economics has also allowed Islamic economists the opportunity to take a critical look at where our problems are and to take the necessary remedial action.

What are the decisions that need to be taken? Although Islamic economics may not be in 'crisis' as modern neoclassical economics, improvements can be made so that it can move forward. What are the options that we have? I hope to answer these questions by looking at some methodological issues that face Islamic economics.

2. Methodology of Islamic Economics: Some Issues³

In this section, we briefly present an overview of the definition of methodology, a brief survey of what Islamic economists have written in the area of methodology and point to some major methodological challenges that need to be addressed if we want to develop Islamic economics.

2.1 What is Methodology?

Methodology can be seen as a specific part of that branch of philosophy called epistemology. In epistemology, we study the theory of knowledge, the sources of knowledge, the application of knowledge and the limitations of knowledge; whilst in methodology, the study is narrower and more specific on how to develop knowledge (theories) and how to evaluate the knowledge (theories) produced.

Blaug (1993) and Dow (1996) defines methodology of economics

as the branch of economics where we study how economists justify their theories, and the reasons they offer for preferring one theory over another. Machlup (1978) also clarified that:

Although methodology is *about* methods, it is not *a* method, nor a set of methods, nor a description of methods. Instead it provides arguments and rationalizations which support various preferences entertained by the scientific community for certain rules of intellectual procedure, including those for forming concepts, building models, formulating hypotheses, and testing theories.

Methodology implies not merely the technical procedures (modeling techniques) used, the choice of categories and preferred integration procedures, but the underlying conceptualization of reality (the worldview) in relation to the preferred mode of reasoning as well as the standards used to appraise theories (Dow, 1996; Machlup, 1978).

Again Machlup (1978) states that:

Methodology is neither a study of good methods nor a study of methods used *per se* (emphasis added) but rather a study of the reasons behind the principles on the basis of which various types of propositions are accepted or rejected as part of the body of ordered knowledge in general or of any special discipline.⁴

Methodology analyses the process through which knowledge about economic phenomena is authenticated. Methodology does not simply mean methods, techniques or several procedural steps needed for appraising theories. Methodology is beyond that. Its interest is to investigate the criteria, rationalization, arguments and justifications for theory appraisal as well as testing and proving the reliability of that theory. The techniques, methods and steps of interaction come much later after the criteria and arguments are clearly established. This meaning and understanding of methodology is not fully reflected in the works of the Islamic economics scholars reviewed. A survey of

writings is summarised below:

Table 1:
Theory Appraisal in Islamic economics: A Survey of Scholars' Views

Scholar	Year	Objective	Approach
M.A. Mannan	1983	To produce economic theory based on Islamic framework	<ul style="list-style-type: none"> • Identify the economic issues/problems • Search for the explicit and implicit guiding principles of the <i>Shari'ah</i> • Theoretical formulation of the problem • Prescription of policy • Implementation of policy • Review and evaluate the policy implemented • Results of the evaluation
Muhammad Anwar	1990	To promote growth of knowledge of economics within an Islamic framework by: <ul style="list-style-type: none"> • Islamizing modern economic theories • Developing economic theories independent of Western thought 	<ul style="list-style-type: none"> • Contrast component of conventional theory with selected components in the Islamic <i>corpus</i> and <i>nucleus</i> • Apply <i>ijtihad</i> to classify components of conventional theory into Islamic and neutral elements. • Discover substitutes of the un-Islamic elements through <i>ijtihad</i>
M. Umer Chapra	1996	To produce Islamic economic theory that fits within the logical structure of the	<ul style="list-style-type: none"> • Methodological Pluralism • Scrutinize the economic hypothesis whether it fits within the logical structure of the Islamic paradigm • Yes. Evaluate the hypothesis

Scholar	Year	Objective	Approach
		Islamic paradigm as defined by the Qur'an and <i>Sunnah</i>	<p>through logical reasoning in the light of the teachings of <i>Shari'ah</i></p> <ul style="list-style-type: none"> • Yes. To test and provide empirical evidence continuously.
Mohammed Aslam Haneef	1997	To produce Islamic economic theory by using its own framework and its own criteria	<ul style="list-style-type: none"> • Identify all the verses of the Qur'an and <i>Sunnah</i> which relate to economics • Systemizing into principles, postulates, hypothesis, precepts and assumptions • The process of integration, examination, and filtering the contemporary Western economic thought • Evaluating the strength and reliability of the theories appraised by using contemporary scientific method as well as Islamic framework and criteria
M. Anas Zarqa	2003	To produce an "Islamic science of economics" by the interaction and integration of "Islamic assumptions" and "economic assumptions"	<ul style="list-style-type: none"> • Replacing the preconceived values of conventional economic theories by Islamic values. • Adding the Islamic descriptive statements about economic life into contemporary economic theory • Product: <ul style="list-style-type: none"> ○ Islamic normative statements and assumptions ○ Islamic descriptive statements that are related to economics

Scholar	Year	Objective	Approach
			<ul style="list-style-type: none"> ○ Descriptive economics assumptions and statements that is not against Islamic principles
Monzer Kahf	2003		<ul style="list-style-type: none"> ● Elaboration of Islamic economic system that consists of philosophical foundations, principles, axioms, assumptions and sets of operational rules by: <ul style="list-style-type: none"> ○ Theoretical discovery of all the components of the system and its internal coherence ○ The investigation of economic validity and applicability of the system including the way variables and behaviour are affected ● Revision of Conventional economic theory: <ul style="list-style-type: none"> ○ <i>Takhliyah</i>: Identify and isolate the biased postulate ○ <i>Tahliyah</i>: Incorporate the positive postulates derived from <i>Shari'ah</i>
Baqir al-Sadr	1983	To discover the doctrinal basis of Islamic teaching concerning economics, e.g. ownership, production,	To study all laws/injunctions that are related to economics to discover the doctrine as the upper structure of Islamic economics which is to be the base where numerous theories can be derived Approach is similar to <i>fiqh</i>

Scholar	Year	Objective	Approach
		consumption, distribution, <i>etc.</i>	
Zubair Hasan	1998	<ul style="list-style-type: none"> • To “rediscover” the Islamic doctrines and systems • To set the goals for Islamic economists • To prescribe behavioral norms for their achievements • To formulate rules for evaluating the results 	<ul style="list-style-type: none"> • To discover the doctrine- can adopt <i>fiqh</i> approach • “Step by step” approach by sifting, pruning, and modifying, where possible, conventional economic theories to conform to the <i>Shari’ah</i> tenets
S.H. Naqvi	1981	To develop a systematic analytical framework of the ethico-economic teachings of Islam into a set of axioms from which the professional economist can deduce policy-relevant conclusions	<ul style="list-style-type: none"> • Axiomatic approach • Islamic economic theories is derived from the four axioms of unity, equilibrium, free will and responsibility

2.2 The Missing Dimension of Contemporary Islamic Economics: Methodology

A majority of scholars reviewed tend to prefer an integrative approach for theory building in Islamic economics, *i.e.* a process involving

interaction between Islamic and modern sciences. The basic argument is that the positive side of the advanced development of modern economics could be worthwhile and can be utilized for the purpose of developing Islamic economics. The body of Islamic economics that is intended to be created, and later on developed into a new discipline with a distinct body of knowledge, methodology(ies) as well as theories, should not necessarily start from zero by ignoring all the wisdom of modern economics which have been generated through the long process of intellectual interaction and debate/discussion.

The exceptions to this approach may be Choudhury (1986) and Zaman (2012). The former's meaning of 'integrative' may be quite different. Judging from his writings, it would seem that he does not support the use of existing concepts as well as the possibility that their meanings could be merely modified. Integrative to him would mean starting with developing original concepts, with unique meanings that represent a 'reality' that encompasses both the physical and spiritual realms. A new math, a new symbolic logic and formalism is needed. The latter argues for a rejection of neoclassical economics since he says that they are two 'conflicting bodies of knowledge' that have very different worldviews and fundamental notions of existence.

While I agree that the worldviews vary, and are in certain aspects in conflict, I am still of the opinion that we can utilise modern economics, provided we have clear criteria that enables us to know what we can accept, what we have to reject and what we need to modify and of course, how to do that, in line with Islamic criteria. For this, it is imperative that genuine 'methodology' research be done and we have 'principles/criteria on which we can argue for validity or otherwise of legitimate knowledge'. The Islamic economic methodology discussions over the last 30 years clearly indicates that Islamic economists have not really discussed 'methodology' and much more research needs to be undertaken especially to set the 'criteria' for theory appraisal in Islamic economics and how to evaluate the reliability of theories in an Islamic framework so that a clear methodology of Islamic economics and a strong foundation of Islamic

economics can be established.

Whenever Islamic economists have attempted to talk of methodology, they have always referred to *usul al-fiqh*. In papers written in the early 1980s, Abu Saud called for the need to develop a methodology for the behavioural sciences rather than depending on *usul al-fiqh*. Idris (1987) also discussed certain methodological principles he thought were the basis of a methodology that would have to take into consideration both revelation and the universe as sources of knowledge. Safi (1992) stated that the Islamization of knowledge agenda— which is supposed to be primarily an epistemological and methodological agenda—was, after nearly 20 years, still in a ‘pre-methodological stage’ (Haneef, 2009). This is because works written by scholars, including Islamic economists, never discussed methodology as defined earlier. Those who were trying to talk of methodology, referred to *usul al-fiqh* that was understood as methodology of Islamic law/jurisprudence.

3. The Need for Genuine Interaction Between Turath Al-Islamiyy and Modern Sciences

While we mentioned that a majority of the scholars writing in Islamic economics favor ‘interaction’ between Islamic heritage and modern sciences’, the understanding of this highly complex task varies considerable from good insights to mere superficial patchwork. In addition, the process of ‘corruption of knowledge’ used by Al-Attas (1978) to explain among others, the narrowing down of important terms and concepts in Islamic scholarship to meanings that are focused only to law (such as *shari’ah* and *fiqh*) has had serious adverse implications for the understanding of Islamization of knowledge efforts (in this case economics, and finance) as well as the development of proper methodological foundations for Islamic economics. *Shari’ah* is meant to be total guidance for human beings and comprises of values, norms, principles and laws that should guide our every action.

One can see the problem mentioned by al-Attas in the practice of

Islamic Banking and Finance. The whole process of ‘*shari’ah* advisement’ and the composition of ‘*shari’ah* advisory boards/committees’ are made up almost exclusively of people who have an Islamic law background. The views expressed are hence limited to the legal dimension and to legal requirements. Even if due to repeated criticism, this is acknowledged, the capacity for existing boards to give qualified and meaningful ‘*shari’ah* guidance’ may be too much to expect.

The *Shariah* Governance Framework (SGF) introduced in Malaysia has required that *shari’ah* committees consist of 5 members (from 3 previously) and from preliminary studies, it seems as if the composition of these new committees has been widened to include people from finance, accounting and economics. While this is welcome, the more important issue is the capacity of these members to integrate both the *turath* and modern sciences, rather than merely their numbers or stated areas of expertise.

3.1 *The Need for Uṣūl al-iqtisād*

As far as methodology is concerned, the present author has argued the need to develop *usul al-iqtisad* or something that deals with social sciences. *Uṣūl al-iqtisād* would involve a much wider scope of subjects than *usul al-fiqh* as understood in today’s narrowly legalistic perspective. On the contrary, *uṣūl al-iqtisād* would have to include knowledge of areas such as the Islamic worldview, its Islamic economic vision, philosophy, including its ontology, axiology, and especially epistemology (including methodology) relevant for Islamic economics and other social/human sciences (Haneef and Furqani, 2007).

Uṣūl literally means “origin”, “roots”, “principles”, “fundamentals”, “rudiments” or “elements” of a particular thing. *Iqtisād* literally means “moderation”, “in the middle” and also means economics. Nowadays, economic science is translated into Arabic as *‘ilm al-iqtisād*. Putting both these meanings together would therefore mean the principles, fundamentals or even foundations of economics,

including its methodological dimension.

For the purpose of this paper, we can focus more on methodological aspects and define *uṣūl al-iqtiṣād* as the methods of how to derive and appraise the organizing principles, concepts and theories of Islamic economics from the primary sources of Islam (*naqliyyah*) i.e. the Qur'ān and *Sunnah*, as well as the secondary sources (*'aqliyyah*)—through *ijtihād*,—that would include reasoning, experimentation, and observation. Whereas the former provides the basic evidence and indications from which detailed rules may be derived, the latter is needed for the elaboration and detail of the former, including procedural guidelines to ensure correct utilisation of the primary evidence.

In brief, several characteristics and purposes of *uṣūl al-iqtiṣād* as the methodology of Islamic economics can be delineated as follows;

1. *Uṣūl al-iqtiṣād* is an integration of methodology developed in our Islamic heritage (including *uṣūl al-fiqh* and other *uṣūl* of sciences developed in our heritage) and contemporary economics (which may involve the whole spectrum of conventional economics and not just the neoclassical school). *Uṣūl al-iqtiṣād* would have to deal with the primary sources of Islam (*naqliyyah/revealed*) i.e. Qur'ān and *Sunnah* as well secondary sources (*'aqliyyah/reason*) i.e. reasoning, experimentation and observation of both our legacy and of modern economics.
2. As a methodology of Islamic economics, *uṣūl al-iqtiṣād* aims at delineating the principles that could be used to appraise Islamic economic theories. It would have to develop principles that would have to deal simultaneously with both types of knowledge, *naqliyyah* and *'aqliyyah*. Rather than treating the heritage and modern economics separately, these principles must be integrated through a methodological dialectic and creative synthesis.
3. One thing should also be noted is that Islam has revealed sources (Qur'ān and *Sunnah*) and non-revealed sources, such

as analogical reasoning (*qiyās*), consideration of public interest (*istiṣlāh*), juristic preference (*istiḥsān*), presumption of continuity (*istishāb*), and so forth. Whereas the revealed sources may have clear injunctions and command permanent validity, their interpretation via *uṣūl al-iqtisād* and its non-revealed sources are not permanent, for they are mainly the product of an *ijtihād*.

Keeping the previous paragraphs in mind, it is relevant to mention that Fox (1997) suggests that discussions on methodology have to keep four questions in mind: what is the purpose of economic inquiry, what are the legitimate sources of economic inquiry, what is the scope of application of economic knowledge and what is the appropriate structure of an economic theory? Of the four, Islamic scholarship seems to have focused only on the second question. Consequently, the other equally important ‘methodological’ discussions that should also be undertaken do not really exist in the works of Islamic economists. Most works purported to be on methodology lack discussion on the principles and criteria that would justify ‘Islamicity’ of a theory in the process of interaction and assimilation of conventional concepts/theories into an Islamic framework. Even this article merely surveyed briefly the writings and pointed out the issues and challenges, but does not discuss methodology of Islamic economics itself. It is probably here that Choudhury’s and Zaman’s writings appeal to some in that they are calling for rather fundamental reforms bordering on a ‘revolution’ in approach.

Whether you agree with Choudhury and Zaman or not, what is needed next can be divided into three tasks:

1. Islamic economists should critically review the methodological principles or criteria that are widely discussed in conventional economics such as falsification, verification, rhetoric, *etc.* These have not received responses from Islamic economists writing on the subject so far.

2. Principles on dealing with the heritage especially its economic/social science dimension, needs to be elucidated.
3. Integrating the results of the first two tasks in an organic manner should be attempted. The 'creative synthesis' talked about in the Islamization of Knowledge agenda, should include methodological principles and criteria.

In addition, in attempting to build an Islamic economic methodology, there may also be a need for Islamic economists to answer the first question put forward by Fox (1997), *i.e.* 'what is the purpose of economic models and theory'. Is the purpose for understanding, description, explanation, prediction, or persuasion; or something else; or all of the above?

More than 30 years ago Dugger (1979) in his study comparing institutionalist and neoclassical economic methodology, showed that their purposes of building models were different. In neoclassical economics, prediction is the main goal of economic models and theory, hence basic postulates (such as assumptions of utility maximization) in a predictive model is tested *i.e.* by empirically comparing deductions (quantitative predictions) with observations, *i.e.* seeking 'empirical validity'. However, in institutional economics, the main aim is to understand behavioural patterns given certain institutional settings. Hence 'pattern models' are tested by comparing hypothesized institutional structures with observations. The former could be characterised as more 'outcome' focused, while the latter is more 'input focused'. Hence the approach, unit of analysis, principles and criteria used in both schools legitimately vary. Very few, if any Islamic economist asks this question or is aware of its implications for developing Islamic economic methodology.

What adds to the challenge faced is that those principles or criteria (that are discussed in mainstream economics) are taken as 'given' although they only represent one school of economics, and hence may have been designed in accordance with a framework in mind. This mainstream methodology may need to be critically evaluated from Islamic perspectives as it may be unable to cope with

contemporary complex realities, nor with the richness and multidimensional nature of Islamic concepts (Sardar 1988). The resurgence of methodological studies among academic circles in the west over the last 40 years is a reflection of their uneasiness with hegemony of mainstream economics. However, many in the west have realized their 'foundational' mistake. Islamic economists should take cue.

If this critical evaluation is not done, it will leave the young Islamic economists who are involved in the process of developing Islamic economics unaware of what is 'acceptable' or 'unacceptable' *and why this is so*. If the Islamic methodological principles to establishing good theory over bad theory is not developed, one can only see 'palliative' works or worse still, patchwork efforts being undertaken since Islamic economists would unwittingly use 'Western criteria' for building and evaluating economic theories and that too of neoclassical economics. Hence, this would distort the potential of Islamic economics as a distinct discipline. By highlighting these points, we hope that future research agenda will include the methodology agenda.

3.2 Is Islamization of Economics Possible?

In the discussion of methods rather than methodology and in the absence of Islamic criteria in methodological discussions, the process of Islamization of economics is more likely to be represented by a series of steps or stages or processes that should be followed in creating Islamic economics, as seen from the writings of the scholars discussed in Section 2.⁵ The approach which now has become dominant in developing Islamic economics is criticized as unable to produce a distinct Islamic economics (Sardar, 1988, Kirmani, 1989 and Al-Atas 2006).

The Islamization of economics seems to be done 'dichotomously' between the conceptual (theoretical) and the empirical dimensions. In the conceptual part, Islamic economists attempt to find Islamic justification based on Qur'anic verses over certain theories, while in

the empirical part, Islamic economists just utilize and apply the common statistical methods into an Islamic/Muslim case, assuming no contradiction to Islamic heritage. Islamic economics heavily depends on conventional economics especially the dominant neo-classical paradigm as far as the empirical part of economics is concerned.

Even the empirical side, since it is not based on 'Islamic normative frameworks', cannot give much contribution to developing Islamic economics. It remains within the mainly neoclassical framework and fails to offer alternative paths to modernization. Sardar (1988) earlier also warned that;

“Islamic economics is little more than one huge attempt to cast Islamic institutions and dictates, like *zakat* and prohibition of interest, into a western economic mould. The dominant models guide the analysis and shape the inquiry: everything is compared and contrasted with capitalism and socialism, highlighting the fact that there is an underlying apologia at work.”

This observation nearly 25 years ago betrays a form of 'simplistic Islamization of economics'. It is also a wrong understanding many well-meaning Islamic economists find themselves in and they often get trapped into the conventional paradigm. They may actually be contributing to the 'westernization of Islam', by fitting Islamic teachings into the neo-classical framework rather than the opposite, which is what 'genuine Islamization of economics' would entail. The simplistic Islamization/integration program of modern economics and Islamic teachings has often led into 'replication' of conventional theory with no clear supporting evidence of Islamicity. At most, the current development of Islamic economics is working within the boundaries of neoclassical theory, with some adjustments to incorporate teachings/norms/values that reflected certain requirements of Islam

However, if Islamization is understood as it should be, as primarily an epistemological and methodological concern, interaction

between Islamic heritage and modern knowledge has to be cognizant of the methodological similarities and differences between the two. Attention must be given to developing those Islamic methodological principles that would be able to guide the process of dealing with the *naqliyyah* and *aqliyyah* sciences and their sources. These principles must also be principles that apply to both simultaneously. The present author has to admit that what and how these principles will look like and how they will be applied, is still very unclear. As a start, Furqani (2012) has attempted to highlight these principles and guidelines. I would like to think that our idea of interaction with modern science can be reconciled with the need to have Islamic frameworks as the basis of interaction.

4. Concluding Comments

There are problems in Islamic Economics but they are different from those faced in modern neoclassical economics. Our problems relate to the apparent inability to develop ‘genuine’ Islamic economics. However, what this means and how to go about it—*i.e.* discussing and debating the philosophical aspects of the discipline—are areas that have not really been given sufficient attention by Islamic economists. However, getting consensus on the nature of the problems and the appropriate steps to take may need much more discussion. For the moment, we should accept a pluralist approach since we are still ‘hearing views’. This paper has argued that the methodological framework for Islamic economics can be supported by a proper understanding of the need to integrate *turath al-Islamiyy* and modern sciences. While worldview differences are acknowledged, critical interaction with different frameworks with wisdom is what we have to develop in line with the Prophetic saying that wisdom is the lost treasure of the Muslims and Muslims should reclaim it.

Notes

1. An earlier version of this paper was presented at a Workshop

Organised by the Islamic Economics Institute, King Abdulaziz University, Jeddah, November 12-13, 2012. The institute presented a position paper and had asked various individual scholars to answer the question 'Is Islamic Economics in Crisis?' and to propose possible ways to move forward.

2. See the numerous works of M.A. Choudhury and more recently, see Zaman (2012).
3. Much of this section is taken from Haneef and Furqani (2011).
4. Machlup (1978) then distinguishes between methodology (as defined above) and description of methods used in academic papers/research (what he terms as methodography or simply notes on methods). He takes to task many ignorant writers today who have 'debased' the term to the latter (1978: 7-8) and cautions that in the name of steering away from 'abstract' discussions, we should not be infected with 'methodophobia', a disease that creates a negative over reaction to the mention of the term.
5. While many scholars have contributed to the Islamization of Knowledge (IOK) discourse over the years, all attempts at IOK are by definition, 'step-by-step', involving interaction between Islamic turāth and modern bodies of knowledge/disciplines. Hence, there is no 'all or nothing' approach in the IOK process (Hasan, 1998). There may be some scholars who viewed all modern knowledge as 'unislamic' hence the need to take nothing; some who saw all modern knowledge as 'islamic', hence, take all, but this is not the view of any serious proponent of IOK.

References

- Al-Attas, S.M.N. (1978). *The Dewesternization of Knowledge*. In Islam and Secularism - Chapter 4 (pp. 133-150). Kuala Lumpur: Muslim Youth Movement of Malaysia.
- Alatas, S.F. (2006). *Islam and the Science of Economics*. In Ibrahim M. Abu Rabi' (Ed), *The Blackwell Companion to Contemporary Islamic Thought* (pp. 587-606). USA: Blackwell Publishing.
- Al-Sadr, M. Baqir. (1983). *Iqtisādunā: Our Economics*. Tehran, Iran:

World Organization for Islamic Services.

- Anwar, M. (1990). *Islamic Economic Methodology*. Journal of Objectives Studies, 2(1), 28-46.
- Blaug, M. (1993). *The methodology of economics: Or, how economists explain*. Cambridge University Press.
- Chapra, M.U. (1996). *What is Islamic Economics*. Jeddah: IRTI, IDB.
- Choudhury, M.A. (1986). *Contributions to Islamic Economic Theory: A Study in Social Economics*. New York: St. Martin's Press.
- Dow, S. (1996). *The Methodology of Macroeconomic Thought: a conceptual analysis of schools of thought in economics*. Cheltenham, UK: Edward Elgar.
- Dugger, W.M. (1979). *Methodological differences between institutional and neoclassical economics*. Journal of Economic Issues, 13(4), 899-909.
- Fox, G. (1997). *Reason and Reality in the Methodologies of Economics*. UK: Edward Elgar.
- Furqani, H. (2012). *Philosophy of Islamic Economics: Preliminary Explorations in Developing the Discipline Foundations*. Phd Thesis, International Islamic University Malaysia.
- Haneef, M.A. (1997). *Islam, the Islamic Worldview, and Islamic Economics*. IIUM Journal of Economics and Management, 5(1), 39-65.
- Haneef, M.A. (2009). *A critical survey of Islamization of knowledge* (2nd Edition). Kuala Lumpur: International Islamic University Malaysia (IIUM) Press.
- Haneef, M.A. and Furqani, H. (2011). *Methodology of Islamic Economics: Overview of Present State and Future Direction*. International Journal of Economics, Management and Accounting, 19(1), 1-26.
- Hasan, Z. (1998). *Islamization of Knowledge in Economics: Issues and Agenda*. IIUM Journal of Economics and Management, 6(2), 1-40.
- Idris, M.A.S. (1987). *al-Risalah fi Usul al-Fiqh*, Trans: Majid Khadduri (Second Edition). Cambridge: Islamic Texts Society.

- Kahf, M. (2003). *Islamic Economics: Notes on Definition and Methodology*. *Review of Islamic Economics*, 13(1), 23-47.
- Kirmani, M.Z. (1989). *Islamic Science Moving towards a New Paradigm*. In Ziauddin Sardar (Ed), *An Early Crescent: The Future of Knowledge and the Environment in Islam*. London: Mansell Publishing Ltd.
- Machlup, F. (1978). *Methodology of economics and other social sciences*. New York: Academic Press Inc.
- Mannan, M.A. (1983). *Islamic Economics as a Social Science: Some Methodological Issues*. *Journal of Research in Islamic Economics*, 1(1), 56.
- Naqvi, S. N. H. (1981). *Ethics and Economics: An Islamic Synthesis*. United Kingdom: The Islamic Foundation.
- Safi, L. (1992). *The quest for an Islamic methodology: The Islamization of knowledge project in its second decade*. *American Journal of Islamic Social Sciences*, 10(1), 361-386.
- Sardar, Z. (1988). *Islamic Futures: The Shape of Ideas to Come*. Kuala Lumpur: Pelanduk Publication.
- Unknown Editor. (2009). What went wrong with economics? *The Economist*, July 16. Retrieved from:
<http://www.economist.com/node/14031376> .
- Williams, J.B. and McNeill, J.M. (2005). *The current crisis in neoclassical economics and the case for an economic analysis based on sustainable development*. Working paper No.001/2005, U-21 Global.
- Zaman, A. (2012). *The Crisis in Islamic Economics*. *Journal of King Abdul Aziz University: Islamic Economics*, 25(1), 147-169.
- Zarqa, M.A. (2003). *Islamization of Economics: The Concept and Methodology*. *Journal of King Abdul Aziz University: Islamic Economics*, 16(1), 3-42.

Essential Perspectives in Islamic Economics and Finance reflects contemporary development in the theoretical and practical fields of Islamic Economics and Finance. It presents the latest thinking and trends in the two disciplines and was developed from the papers presented at the 2nd International Conference on Islamic Economics and Economies of OIC Countries (ICIE2013) as well as original paper contributions from the faculty members of the Department of Economics, Kulliyah of Economics and Management Sciences (KENMS), International Islamic University Malaysia (IIUM).

This book covers six important themes which include methodological, conceptual and policy perspectives in Islamic economics, operational aspects of Islamic banks, recent developments in Islamic capital markets, as well as new directions in relation to the institutions of *zakat* and *waqf*. It enables academics, practitioners, industry regulators, policy makers, students and the public to understand recent debates and trends in various areas of Islamic economics and finance from a single volume.

Kulliyah of Economics and Management Sciences (KENMS)

KENMS is one of the first two faculties established in IIUM in 1983. It aims to be a leading faculty of international excellence for teaching, research and consulting services integrating conventional economics, business, accounting and finance-related areas with Islamic values and ethics. As part of KENMS, the Department of Economics is actively involved in various activities to advance contemporary Islamic economics and finance scholarship through research, seminars, workshops and conferences, as well as publication outputs.

Islamic Research & Training Institute (IRTI)

IRTI was established in 1979 as an institutional member of the Islamic Development Bank Group. Its vision is to be the global knowledge centre for Islamic Economics and Finance and has set a mission to inspire and deliver cutting edge research, capacity building, policy dialogue, as well as advisory, consulting and information services to its member countries. IRTI organizes conferences, seminars and training workshops and is actively involved in publishing literatures in Islamic economics, banking and finance.

Editors

Haniza Khalid and **Mohd Nizam Barom** are Assistant Professors at the Department of Economics, Kulliyah of Economics and Management Sciences, International Islamic University Malaysia.

Nasim Shah Shirazi is a Senior Research Economist at the Islamic Research & Training Institute, Jeddah.



Kulliyah of Economics and Management Sciences
International Islamic University Malaysia



Islamic Research and Training Institute
A member of the Islamic Development Bank Group

ISBN 978-983-44568-1-8



9 789834 456818