

**Kyoto Bulletin of Islamic Area Studies
2007, Vol. 1, No. 2**

**A Political Economy Approach to Islamic Economics: Systemic Understanding
for an Alternative Economic System**

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**I. Introduction: The Essentialisation of Islamic Economics Beyond Islamic
Finance**

Islamic finance, which emerged as part of Islamic economics thinking, has gained roots in the global financial system. While *Shari'ah* compliance in finance in terms of legal and mechanical terms is essential and important, the consequences of Islamic financing is also important, as these consequences must fulfil the foundational principles and aspirations of Islamic economics. In this particular point, recent developments indicate that that Islamic finance is moving in another direction towards 'capitalism' by missing the value system of Islamic economic theoretic. Therefore, essentialisation of Islamic economics as a system is crucially important to locate whether it is only an approach as expressed in the practice of Islamic finance or it goes beyond the limited understanding of Islamic financing to a system which aims to be an alternative in terms of 'moral economy' (Tripp, 2006).

This paper is an attempt to discuss the systemic nature of Islamic economics, in which it argues that Islamic economics was borne in its modern version in 1970s with an idea of being an alternative system to the existing capitalist modes of production. In this new discourse, Islamic economics kept the capitalist order responsible for the failure of economic development and also of the consequences of these failure including environmental issues; and therefore claimed to be the alternative as part of identity politics emerged in 1970s.

With the rapid development in Islamic finance, the developments of research in Islamic economics, as the foundational base of Islamic finance, has been little. However, without establishing the foundational norms, which is the ethical system of this new paradigm, it is not possible to have a robust financial system, as in Islamic finance. This paper, therefore, explores the original wisdom in revealing the systemic and alternative system discourse of Islamic economics regardless whether such a system is a possible or not.

II. Islamic Economics as a System

The term system refers to "functional components that together make certain sectors of the ethico-economic order work" (Choudhury and Malik, 1992: 15), which therefore

refers to an integrated whole as part of an order. Islam, in this, represents the order, and within this order Islamic economics, and other systems related to everyday day life is possible. “An ‘order’ is thus a totality of several systems integrated together through the bond of ethical relationships” (Choudhury and Malik, 1992: 15). Various systems, therefore, in the Islamic order are linked through the ethical propositions of Islam. “The Islamic economy is defined within the parameters of its own ethical system, which fact, incidentally, demonstrates its originality and relativity” (Naqvi, 1994: 80). In other words, the ethical norms of Islam is fully integrated with economic motives in Islam, as these are not voluntary actions but, ontologically, part of the revealed knowledge; and therefore its dogmatic nature makes it necessary for them to be followed.

The system understanding is also related to the nature of the structure of an economic world view regardless whether “theoretically articulated and recorded or traditionally practised over years” (Nomani and Rahnema, 1994: 41), because this is the general criticism raised against Islamic notion of economics that it is based on ancient principles of revealed knowledge. However, lack of modern theoretising does not negate its systemic claim, because economic system is a “static registration of how society organises itself to address the basic economic problems of what is to be produced, how many, how and for whom” (Nomani and Rahnema, 1994: 41). Such decision making has existed in Muslim societies albeit it may not have practised in a eurocentric expectation. In other words, since Islamic economic system has a particular moral economic understanding which governs the production, consumption, exchange and distribution patterns and norms in a society through the principles derived and rules and laws established by that system (Nomani and Rahnema, 1994: 41), it is normal that Islamic economics must be perceived as a system

The ethical base of the Islamic economic system provides the value system through which it governs the economic interaction in the society. The Islamic order, in other words, through its ethical economy provides “the economic system with its basis and objectives on one hand, and with its axioms and principles on the other” (Kahf, 1989: 43). The working mechanism of this process is managed by a set of axioms and principles derived from the Islamic order with the objective of bringing “the economy closer to the objectives of the system represents the testable ground of the system” (Kahf, 1989: 43).

The components expected from a system, thus, can be located within the Islamic economic understanding, which makes it a system. However, in order to justify this statement Gregory and Stuart (1985: 12) rightly argues that “in order to distinguish one economic system from another, we need to focus on and compare their fundamental elements”. For this purpose, through a systematic and methodological manner, they provided a number of characteristics that should be sought in a system. By following their systemisation, for constructing the Islamic economic system the followings, hence, are necessary: the organisation of decision-making arrangements; mechanisms for the provision of information and co-ordination; property rights; and incentive mechanism. This paper, however, extends the characteristics which can make a system. Therefore, in order to talk about system understanding in economic realm the following is necessary:

- (i) Framework paradigm (with ontological and epistemological sources) in terms of point of reference;
- (ii) Value system;

- (iii) Foundational axioms;
- (iv) Operational principles/mechanism;
- (v) Specific Methodology;
- (vi) Functional institutions.

In searching whether Islamic economics is proposing an alternative system, these characteristics have to be located among the components of the Islamic economic paradigm. The following sections, hence, attempt to deconstruct the Islamic economics understanding to reveal these components in arguing its systemic nature.

2.1. Islamic Economics: Emergence of Framework Paradigm

In the opinion of the founding fathers of Islamic economics paradigm, the failure of economic development in the post-independent states of Asia and Africa in 1960s and 1970s was attributed to capitalist economic development strategies, which ignored the importance of human being and its well-being. Their objective was, therefore, to develop an economic system understanding as part of the Islamic world order, which could develop a human-centric development strategy. The Islamic economics paradigm, hence, aimed at the creation of the Islamic system of economics with its distinct values, norm, rules and institutions with a politically oriented systemic understanding as ordained in Islamic order. In other words, Islamic economics aimed at a world order, where the ontological and epistemological sources namely the Qur'an and *hadith* determine the framework of the economic value system, the operational dimension of the economy and also the economic and financial behavioural norms of the individual Muslims.

The axioms and foundational principles of Islamic economics define the framework for economic activity to take place within intra-and intergenerational social justice, which reveal themselves in the methodological framework of the Islamic economic system. Therefore it is based on a constructivist ideology, with the aim of forming an authentic Muslim identity as opposed to global dominance of capitalism, which has in reality failed in the economic development process.

In searching the rationale for a distinct Islamic economics, the values and the sources of Islam provides the rationale. It is, indeed, a fact that no human endeavour is value-free, which implies that reality including economic reality is socially constructed. Despite the modernist projection of universal values, in every day life of individual, each action is produced and acted through the socially constructed manner; and therefore there are all those differences exist in social, political, economic, religious etc. lives on earth. In a similar manner, "economic systems ... do not function within a vacuum [eitheer]. They are significantly affected and shaped by a set of 'influential factors': the level of economic development; social and cultural factors; and the environment (Bornstein, 1979: 7). This hence implies that "religion, ideology or any strongly held set of values, ideals and mores have an impact and influence which have to be taken into serious consideration" (Nomani and Rahnema, 1994: 43).

This is in accordance with the philosophical foundation of social sciences. Therefore, Mill, the founder of political economics, refer to different construction of economic understanding when he argued as back as in 1836: "... in whatever science there are systematic differences of opinion ... the cause will be found to be, a difference in their

conceptions of the philosophic method of the science, the parties who differ are guided, knowingly or unconsciously, by different views concerning the nature of the evidence appropriate to the subject. They differ not solely in what they believe themselves to see, but in the quarter whence they obtained the light by which they think they see it” (Mill, 1836).

Thus, economics, and finance, is value-loaded, as at the most abstract level, which is shaped by our values derived from our worldview, as part of our social construct. Hence, this provides rationale for a distinct economic system. Since factors affecting worldviews differ, different worldviews exist leading to different ‘systems’ for different peoples. Consequently, Islamic economics system differ from the prevailing economic systems due to the following:

- (i) Foundations, operational principles, goals differ;
- (ii) Concepts and theories differ;
- (iii) Epistemological source differ, as Islamic worldview based on the Qur’an;
- (iv) Fundamental concepts in the Qur’an are not open for changes in meaning.

Islamic economics, hence, aimed at creating a new system, the features of which, as a system, can be defined as:

- (i) It is part of *din* (religion), Islam;
- (ii) It deals with production, consumption and distribution activities of human beings according to Islamic worldview;
- (iii) It makes economic and financial choices according to Islam;
- (iv) It describes, analyses, and prescribes.

Such philosophical and operational distinguishing characteristics make Islamic economics a system as defined above. Thus, it is an “approach to, and process of, interpreting and solving the economic problems of human beings based on the values, norms, laws and institutions found in, and derived from the sources of Islam”. Regarding the place of Islamic finance within this system, it is only the institutional aspect of Islamic economics, as to finance the economic activity in an Islamic framework, there is a need to have particular institutions using instruments according to rules and regulations, which are all bound by the *Shari’ah*.

2.2. Foundational Axioms-Philosophical Foundations

After establishing that Islamic economics is a systemic political economy in nature, in which epistemology, institutions and functions are all interlinked through the revealed knowledge, in order to assess its systemic nature it is also important to search for foundational axioms or the philosophical foundations, without which it is not possible to talk about an economic system. “It is these foundations which generate the behaviour of the economic agents as well as the institutions in the system; and hence effectively determine the micfoundations of that economy” (Arif, 1989: 84).

The leading Islamic economists such as Chapra (1994 and 2000), Siddiqi (1991), Naqvi (1981 and 1994), Ahmad (1980, 1994 and 2003) and Sirageldin (2002) have developed an axiomatic approach to develop conceptual foundations of Islamic economics by treating Islamic moral economy or the ethics as an ideal through which economic and social policies dealing with economic life, as well as every aspect of human life, are assessed.

It should be noted that the philosophical foundations of Islamic economics is entirely different than that of the other systems, such as capitalism and socialism, as in this approach Islam is seen as a system of ethics. This indeed provides an important pillar through which its systemic nature is established.

The philosophical and conceptual foundations or the axioms of this system are as follows:

Tawhid (God's unity and sovereignty): The Islamic worldview is based on *tawhid*, or the Oneness of God. This "particularly denotes vertical dimension of Islam – linking the imperfect and finite social institutions with a Perfect and Infinite Being" (Naqvi, 1994: 26). In this vertical dimension and vertical equality of the Islamic ethical system, each individual is equal in the sight of Allah; and therefore, each individual has the same distance in relation to their proximity to God. *Tawhid*, as the essential part of this system, provides for freedom of action whereby each individual is viewed as an integral part of the whole. It also implies a continuous and sustained system through "*risalah* (God's prophets as the source of divine guidance); *akhirah* (life-after death, that is the continuity of life beyond death and a system of accountability based on divine law) (Ahmad, 2003: 193). These idioms provide the framework for economic activity to take place within Islamic norms.

Al-'adl wa'l-ihsan (Equilibrium and Beneficence-Socio-Economic Justice): Individuals are expected to establish justice (*'adl*) and promote beneficence (*ihsan*), which, consequently "denote a state of social equilibrium" (Naqvi, 1994: 267). While this axiom implies "giving everyone their due", together with *tawhid* it "results in attaining high levels of good life (*hayat al-tayyebah*), both individual and collective" (Ahmad, 2004: 193), namely the homoeconomics (if we are to use the analogy from conventional economics). This axiom, thus, provides for the horizontal dimension of equality "of all the virtues of the basic set of social institutions – legal, political and economic" (Naqvi, 1994: 27). In this intra-and inter-generational equality, human beings and societies are expected to establish a balance between the needs of present and future generations, develop policies to meet fulfil the needs of individuals, enable individuals to earn respectable source of living, to develop policies for equitable distribution of income and wealth within the growth and stability oriented policies.

Ikhtiyar (Free-will): In the Islamic economic systemic understanding, human are believed to be endowed with free-will. Although it is "both unrestricted and voluntary" (Naqvi, 1994: 29), it is guided by broad guidelines in order "to interpret-reinterpret that freedom within specific societal contexts, and to suit the needs of changing times" (Naqvi, 1994: 31; emphasis is original).

Fard (Responsibility): This axiom states that although 'responsibility' is voluntary, individuals and society need to conserve for the public good as part of *tawhid* and hence being vicegerent of Allah on earth. In addition to having responsibility towards God, to his/herself and the others in the society, "these three facets of responsibility only underscores the central ethical principle that the individual, though possessing a distinctive personality of his own, becomes even more distinguished as an integral part of the totality of mankind" (Naqvi, 1994, 33). Being conscious part of the society implies a functional responsibility towards society. Hence, in economic terms, there is a social aspect of every asset owned or managed by private or public entities.

Rububiyah: This as an important axiom of the Islamic economic system refers to “divine arrangements for nourishment, sustenance and directing things towards their perfection” (Ahmad, 1979: 12). This implies the necessity of economic growth and development in a sustainable manner in terms of having harmony between various components of economic and social life. It is expected that within this balanced and sustainable environment as defined by Qur’anic principles that human efforts take place.

Tazkiyah, in the Islamic economics axiom, is “concerned with growth towards perfection through purification of attitudes and relationships” (Ahmad, 1994: 20). This is natural consequence of *tawhid*, *adl*, *fard*, and *rububiyah* in an integrated manner, as it directs individual towards self-development, economic and social development in a harmony in the sense that whatever the growth activity is it should be purified. In other words, it refers to growing in harmony in every aspect of life. “The result of tazkiyah is [therefore] *falab*, prosperity in this world and the hereafter” (Ahmad, 1994: 20).

Khilafah and human accountability before God: Allah (swt) created human beings with the role of being God’s vicegerent on earth. By this “his (or her) role, position and mission is described as *istikhlaf*, that is fulfilling God’s will on earth, prompting what is good, forbidding what is wrong, establishing justice (*adl*) and promoting beneficence (*ihsan*), resulting in attaining high levels of good life (*hayyat al-tayyebah*), both individual and collective” (Ahmad, 2003: 193). Thus, being vicegerent on earth defines roles and responsibilities and the reasons of existence of the individual. “From this follows the unique Islamic concept of individual’s trusteeship, moral, political and economic, and the principles of social organisation” (Ahmad, 1979: 12). Thus, the implications of *khilafah* are that of universal solidarity, sustainable consumption of resources, which are trust from God, pursuing a humble life-style, and having human freedoms to conduct daily life. It should also be noted that with human accountability before God, or *akhirah*, Islamic economic system is based on two dimensional utility function, both of which works in positive correlation with each other, i.e. the more social good one does in this world, the more *sawab* or glad tidings one will get in the hereafter.

Maqasid-al Shariah or the objectives of Shari’ah provides the legal-rationale framework within which the economic activities should be conducted. As the last axiom, it aims to interpret the text and in restoring the principles of Islamic economics in relation to the objectives of the *Shari’ah*. This further is interpreted in a way that Islamic economic principles must lead to ‘human well-being’. The objective of the Shar’iah, namely the Islamic way and code of conduct, are described by al-Ghazali (d. 505 AD) as “to provide the well-being of all humankind, which lies in safeguarding their faith, their human self (*nafs*), their intellect (*‘aql*), their progeny (*nasl*) and their wealth (*mal*). In other words, as can be seen, it provides the motivation through which economic activity should take place.

Recent re-interpretations of the *maqasid* by Siddiqi (2004) provides a more dynamic nature to this foundational axiom, as it can be seen that the defined objectives of *Shari’ah* in the words of Al-Ghazali clearly demonstrates that these are all individual oriented objectives without social connotations. Thus, in order to have a properly defined value system of Islamic moral economy, it is important to examine the nature of the *maqasid*, because as Siddiqi (2004) pointed out for a systemic and dynamic understanding “*maqasid al-Shari’ah* could not be confined only to protection (*hifz*), preserving what people had or saving them from harm, rather they must include broader measures ensuring welfare [as] asserted by Ibn e Qayyim ... who emphasized justice and equity. Furthermore, he

insisted that the means to justice and equity could never be captured by a finite list. Reason will guide us how to ensure justice and equity in changing circumstances”. Thus, a dynamic understanding for the circumstances we are in is better conceptualised “with reference to goals of Islam as a way of life rather than being done with reference to the goals of Islamic Law. This will enable us to handle issues like poverty and inequality that a Law-based approach has failed to handle” (Siddiqi, 2004), as objectives of Islam refers to individual as well as society beyond the narrow boundaries of Islamic law.

Consequently, each of these axioms constitutes the microfoundations or the foundational principles of the Islamic economic system, which are entirely different than the axioms and foundational principles of any other system. “The universal ethical system, based on these axioms, is [therefore] believed to produce policies aimed at enhancing motivation to seek knowledge and work, enhance productivity, and enhance transparency in government. They should also enhance intra-and intergenerational equity” (Naqvi, 1994). Thus, the existence and efficiency of these axioms provide the rationale for the Islamic economic system (see: Naqvi, 1994; and Arif, 1989 among others).

2.3. Implications of Foundational Axioms

While the axioms provide the framework within which the Islamic moral economy should work, they have implications for shaping the economic structure in terms of operational and institutional nature of Islamic economics system. For instance, social justice axiom indicates the social responsibility and taking care of the needy in the society. Consequently, *zakah*, as an institution, among others, is proposed to meet the needs of such people in the society, which is a *fard* for those people who are in a position to pay (Ul-Haq, 1996). In addition, *rubbibiyah*, *tazkejah* and accountability before God, as part of the Islamic microfoundations, require “responsible use of rightful earnings by keeping the moral purposes of human beings in view” (Ul-Haq, 1996). This further implies that earning and production is necessary and good as long as it is conducted within a balance with confining the accepted modes of production, and without “misuse, abuse, conspicuous consumption, wastage or *israf*; and squandering or *tabdhir*; its exclusiveness to oneself and denial of the share of the society (*zakah* and other forms of sharing); and the use of socially and ethically wrong or unjust means to produce it – the immoral, prohibited modes, oppressive exploitation of human beings and creation of ecological imbalance or environmental disruption have to be avoided” (Ul-Haq, 1996). Moreover, the axiom *adl* necessitates equal opportunities for everyone, as “individuals must not prevent others in society and nature from meeting their basic biological needs;... all people should have equal opportunities, without discrimination, to benefit from environmental and public resources” (Ul-Haq, 1996). These examples, consequently, clearly demonstrates how axioms work to produce the policies to respond to the issues in the society by instituting the operational dimensions.

It is also important to determine the operational and institutional features of Islamic economics system as derived from the stated axioms.

Islamic economic system is based on the understanding that developments of societies are based on the active motivation and individual and collective efforts of the participants of a society in a planned manner. This indeed differs from historical materialism, for instance, and therefore, development methodology is different than other political and economic ideological standings. Indeed, this difference can only be

explained with the vicegerency role given to individuals, who with the given free will, are perceived to be active actors of social change. Every aspect of economic activity is result of individual's decision making within the social constraints. In this, hence, Islam provides the framework containing the doctrine and value-judgements or ethics for the Islamic economy to function as the arena where the choices to be made.

In this balanced change, each constituent of real life activity is taken into consideration through the axioms stated above in an integrated manner. Therefore, the emergence of *homoIslamicus* with heart and mind shaped by Islamic values is expected to be the individual who works towards the (enlarged) *maqasid-al-Shari'ah* which is interpreted as the human well-being. Therefore, "change has to be balanced, gradual and evolutionary. Innovation is to be coupled with integration" (Ahmad, 2003: 194).

With its ethical foundation and propositions, Islamic economic system does not deny the existence of self-interest an important motivation for human action. However, Islamic moral economy suggests that self-interest to be filtered so that not only self-interest but social interest is to be served as well (Chapra, 2000). Thus, the framework provided by the Islamic economic system constraints so that the conflict between the self-interest and social interest to be removed. This framework also draws the line between what is permissible and not as an economic activity; and therefore lawful (*halal*) and unlawful (*haram*) ways of earnings have been defined by the *Shari'ah*. For instance *riba* or usury-interest, gambling, speculation, fraud, exploitation and extortion are all banned by Islam, as they are not the result of productive economic activity.

As a natural consequence of self-interest, Islamic economic system favours private property and private enterprise as the core of economic life as well legal foundation of the society. However, as in the self-interest, private ownership is filtered through the moral codes and *Shari'ah* dimension so that individuals must understand that private enterprise and private "property is a *trust (amanah)* [from Allah], and as such, property rights are subject to moral limits and used as a means of fulfilling ethical objectives – the *maqasid al-Shari'ah*" (Ahmad, 2003: 195; se also Arif, 1989: 86).

As part of self-interest and private enterprise, market provides the institutional framework in which economic activity, from production to exchange and to division of labour to take place. Also market provides the legal framework for contrast to be fulfilled, which is essential part of private enterprise enshrined in Islamic economic system. However, market mechanism is filtered so that social priorities to be served alongside individually oriented utility and profit maximising motives (Chapra, 2000). It is also important to state that within this Islamically filtered market system "economic efforts take place through the process of co-operation and competition (Ahmad, 2004: 195). In other words, competition does not allow creating conflict between self-interest and social interest but rather arranged to work in co-operation so that various individual and social claims to resources can, economically and socially efficient manner, be fulfilled. The regulation of market mechanism to produce social and economic efficiency simultaneously through the *hisba* institution is suggested by Ibn Taymiya (1985). Thus, a moral filter is suggested to regulate the market. In addition, Islamic economics system is contended with government's regulative role to prevent excesses of the market mechanism. Furthermore, to overcome the market and government failure, Islamic economic system developed *waqf* (voluntary organisations, pious foundations) system as a third sector. Moreover, Islamic ethical system instituted voluntary instruments such as charity and legal obligation such as *zakah* to respond to the failures in both the

mechanisms so that the needy to be provided. Importantly, filter mechanisms is endowed with systemic instruments to provide sustainable development through preventing “waste, over-utilization and the excessive exploitation of non-renewable natural resources and the ecological and environmental aspects of moral activity” (Ahmad, 2003: 196), as natural resources and environment is perceived to be *amanah*, or trust from Allah. Furthermore, to facilitate the efficient working of the market mechanism, “Islam lays down an elaborate code of business ethics to ensure honesty, transparency and equity in business and financial dealings” (Ahmad, 2003: 197).

In summarising, Islamic economic system, as can be seen, aims to guarantee individual liberty, freedom of choice, private property and enterprise, the profit motive, but at the same time it aim at providing effective moral filters at different levels of life and activity and established its own distinct institutions to fulfil the *Shari’ah* objectives, namely human well being, economic development and social justice in the society. Ibn Khaldun’s (15th century) framework provides a summary of the interdisciplinary dynamic model of Islamic socio-economic system in evidencing the alternative systemic nature and the political economy of Islamic economics (Chapra, 2000: 147-8):

“The strength of the sovereign (*al-mulk*) does not become consumed except by implementation of the *Shari’ah*; the *Shari’ah* cannot be implemented except by a sovereign (*al-mulk*); the sovereign cannot gain strength except through the people (*al-rijal*); the people cannot be sustained except by wealth (*al-mal*); wealth cannot be acquired except through development (*al-‘imarah*); development cannot be attained except through justice (*al-‘adl*); justice is the criterion (*al-mizān*) by which God will evaluate mankind; and the sovereign is charged with the responsibility of actualising justice”.

In concluding this section, it should be noted that Islam does not prescribe a particular economic system, but provides the core elements and principals, which form the basic philosophy of a system of an economy.

2.4. Methodology of Islamic Economics

In understanding the methodology of Islamic economics, it might be useful to recall the methodological framework of neo-classical/conventional economic system so as to distinguish the Islamic economics methodology:

- (i) The point of departure is methodological individualism.
- (ii) Behavioural postulate: self-interest oriented individuals who (a) seek their own interests, (b) in a rational way, and (c) try to maximise his/her own utility;
- (iii) Market exchange.

Hence, conventional economic system is based on one-dimensional utility function, which leads to *homoeconomicus* – the economic individual in a market system.

The methodological postulates of Islamic economics, on the other hand, can be summarised as follows:

- (i) Sociotropic individual, for whom not only individualism but social concern is a prerequisite;
- (ii) Behavioural postulates: socially concerned God-conscious individuals who
 - a. in seeking their interests concern with the social good,

- b. conducting economic activity in a rational way in accordance with the Islamic constraints regarding individual and social environment and hereafter; and
 - c. in trying to maximise his/her utility seek to maximise social welfare as well by taking into account the hereafter as well.
- (iii) Market exchange is the main feature of economic operation of the Islamic system; however, this system is filtered through an Islamic process to produce a socially concerned environmentally friendly system. In this process, socialist and welfare state oriented frameworks are avoided not to curb incentives in the economy.

Hence, two-dimensional utility function based on present but also the hereafter (due to the accountability axiom) as the reflection of the actions of this world, which leads to *homoIslamicus*, or as Arif (1989: 92-94) names *tab'ay* or obedient human-being, who makes his/her decision related to economic affairs including allocating the resources, in a rational manner. However, "to be a Muslim is a necessary but not a sufficient condition to be a *tab'ay*" (Arif, 1989: 91). To be qualified as a *tab'ay*, one needs to operationalise Islamic principles in every aspects of her/his life as an affirmed Muslim.

It is also important to state that in terms of epistemological sources there is an important methodological difference between conventional and Islamic economics. While conventional economics as part of the secular world view does not accept any other course of knowledge other than human knowledge, Islamic economics is based on divine knowledge (Khan, 1989).

2.5. Mechanisms and Instruments of Islamic Economic System

The preceding sections lay the foundation of the Islamic economics system with an objective to validate the claim that Islamic economics is an alternative system with its distinct value system, axioms, foundational principles and micro institutions. As part of this systemic nature, Islamic economics provides institutions through which economic and financial activity is conducted with the defined norms and principles. In other words, "an Islamic economy is different from the other economic systems of the world as it calls for a different institutional set up and a unique role of government to achieve the goals of the Islamic society" (Arif, 1989: 87). Islamic institutions are related to business (*muamalat*) but also to the governance of the economy and market, such as *hisba* as a regulative institution for the market system.

Islamic economic and financial activities are shaped by these kinds of measures and institutions:

- (i) Positive measures, such as *zakah* (compulsory alms-giving) to respond to the needs of the poor. Methods have been developed to systematically manage the *zakah* funds to enhance the positive impact of *zakah* on alleviating poverty. In other words, instead of giving to individual poor for their immediate consumption, developing projects for the sustainability and survival of the poor is the new strategy with *zakah* funds.

Hisba is another important positive measure or institution of Islamic economics system to regulate the market mechanism by responding to its failures and shortcomings and overcoming its excesses.

(ii) Voluntary measures, such as *sadaqha* (charitable giving), aims at providing the immediate needs of individual. *Waqf*, or pious foundations, as part of the voluntary third sector aims to provide the goods and services which could not be provided or could not be sufficiently provided due to the failure of the market mechanism as well as government failure. For instance, in addition to *awqaf* aiming at providing health services, education, and food distribution etc., the use of funds accumulated in *waqf* in efficient manner is being developed through cash-*waqf* to enhance their contribution to the economic development of the societies.

(iii) Prohibitive measures, such as *riba*, which is pre-determined interest. It is prohibited as it is unlawful gain in terms of not being product of productive economic or financial activity. Islamic economics proposes profit and loss sharing and risk taking and sharing against pre-determined capital gains to motivate the individuals to actively engage in the economy. The objective of the prohibition of *riba* is not only social justice but also economic and social optimality.

For this Islamic financial institutions in the form of modern banks have been established since late 1960s, which should function according to the values, axioms and principles of the Islamic economics system. The growth in the development of Islamic finance has been remarkable with over three hundred Islamic banking and financial institutions operating not only Muslim countries but also over seventy countries in the world. The assets of these institutions are estimated to be about \$500 billion with about ten to fifteen percent growth rate, which is unprecedented in the global financial world.

Takaful or Islamic insurance is another important aspect of Islamic financial institutions, which operates on non-interest base. While it provides Islamic compliant insurance products for individuals and most importantly for business, it manages funds in an Islamic manner to contribute to economic growth.

All these essential Islamic institutions and instruments aim at enhancing human well being, or the *maqasid*, which constitutes the operational dimension of Islamic economics system. Their existence and successful operation is an indication that Islamic economics is a system of its own with its values, axioms, foundational principles, and also with its particular institutions, which work within the Islamic framework.

II. Conclusion on the Systemic Nature of Islamic Economics and Reflecting on the State of Islamic Finance: ideals and Realities

As the preceding discussion on the analytical tools and value system of Islamic economics indicates, it aimed at creating a world order with political aspirations. In this identity politics, the Islamic version of the modern institutions and behavioural norms such as the *homoIslamicus* or *tabaa'ya* individual are sought for. In other words, Islamic economics with the conceptualisation of *homoIslamicus* proposed a normative world, which states 'what people should strive towards, as opposed to how people are likely to behave (the 'ought' as opposed to the 'is')'. However, Islamic economic system is not devoid of positive economic statements or hypotheses. Several areas of economics are truly positive and cannot be different in an Islamic or in any other framework (Zarka, 1989).

Since Islamic economics fulfils the prerequisites of a system understanding by having a framework paradigm; a value system; foundational axioms; operational

principles/mechanism; a distinctive methodology; and its functional institutions to operationalise its framework, value system, axioms, operational principles working according to its methodology, it can be argued without hesitation it represents an alternative system. In addition, the axioms and philosophical foundation of the Islamic moral economy constitutes the universal ethical system, which implies that “policies should not lead to dependency, limit opportunities that develop capabilities for the few, or reduce individual responsibilities for taking action. Policies should enhance motivation to seek knowledge, enhance productivity, and enhance transparency in government. They should also enhance intra-and intergeneration equity” (Sirageldin, 2002: 27). This indicates that Islamic economic system’s policy orientation, which enhances its systemic nature. Furthermore, since “the validity of an economic system can be tested by its internal consistency, its compatibility with the system organizing the other aspects of life, and its provision for improvement and growth” (Kahf, 1989: 43), it can be argued with the analysis above that Islamic economics has a system of its own which is distinct from the other hegemonic systems. Thus, “Islamic system per se has the capability of providing the operational norm and workable model, providing other things are equal. And these ‘other things’ are: (a) the degree of adherence to Islamic norms and ideals, (b) the politically strong Islamic state, (c) the lack of hostility from the political machinery to Islam internally, through national governments, and externally, through international pressure, and (d) the adaptability of Islam to new changes in society, technologically and otherwise” (ElAshker and Wilson, 2006: 400).

As ElAshker and Wilson states micro and macro social and political environment must facilitate its working for Islamic economics system to function as a system. However, since Muslims did not have the necessary global power failed to establish their political and, hence, economic order. This has consequences for Islamic finance, which is the operational tool of Islamic economics, as Islamic finance has become part of the capitalist financial system, while in the aspirational sense Islamic finance aims to operationalise and fulfil the economic systems of Islam. Despite such a system understanding, a critical approach to the development of Islamic finance, however, indicates a very pragmatist development. In other words, since the systemic understanding of Islamic economics could not be achieved, Islamic finance has developed its own working framework in a very pragmatist manner, as it has ended up being located within the neo-classical paradigm. Thus, in its current state, Islamic finance does not seem to share the foundational claims of Islamic economics, despite the fact that the founding fathers of Islamic economics, in a modern sense, aimed at creating an Islamic economic system with Islamic finance being the operational aspect of that system.

The result, therefore, has been the divergence between the assumptions, normative principles and aspirations of Islamic economics as a system and Islamic finance as an instrument of that system. Therefore, “A distinctive feature of the recent discussions on Islamic banking has been the growing wedge between its conventional theory and current practice” (Hasan, 2005: 11). In particular since the 1990s, while the operations of Islamic finance and the nature of Islamic modes of financing have expanded, the lives of individuals have not been touched upon by this enormous growth. The realities of financial markets which prioritise economic incentives rather than religious behavioural norms has forced the Islamic finance to become part of the international financial system, in which it is recognised as heterogenisation of financial products deprived of their value system. Since the 1990s, therefore, Islamic finance represents hybrid financial products of the international financial system. Thus, the difference has been reduced to

technicality, and the value system is no longer mentioned beyond describing the prohibition of *riba* in quotation verses from the Qur'an.

The realism of this constructivist ideology is tested with the developments which have taken place in Islamic finance, which has given up the value system, identity politics and systemic understanding of Islamic economics and has become part of the international financial system, which has been criticised by Islamic economists for its failure for economic development in the Muslim world and also for being materialistic.

Indeed, this epistemological difference is related to the modern interpretation of the Qur'anic verses and Islamic injunctions. The pragmatist position of Islamic finance as opposed to the foundational and aspirational position of Islamic economics is based on the notion that "the revealed word of God in the Qur'an itself embodies rational economic principles that are quite in line with the modern assumptions of neoclassical economic theory. As a form of universally applicable theory about human beings' economic behaviour, economic theory necessarily is in accord with and confirms the source of universal knowledge, the *Qur'an: homoIslamicus* and *homoeconomicus* are one and the same" (Maurer, 2005). On the contrary, Islamic economics' reading of the same Shari'ah rules emphasize social justice, need fulfilment and redistribution, namely a socio-political reading within a political economy framework.

Despite the mentioned deviance, this paper does not suggest that IBFs should be restructured to incorporate the authentic appeal to the ethics and social justice. On the contrary, they should be perceived as the second best solution, which could not achieve the framework provided by the Islamic economic system understanding. IBFs, therefore, should remain to respond to the market as they are in the capacity of commercial banks, as "the current Islamic experience, notwithstanding its limitations, has proved to offer an invaluable service for both consumer and producer needs and it may well remain for this particular purpose" (Tag El-Din, 2004).

Accepting that the current state of Islamic finance as the second best solution requires new models of development within the authentic notion of Islamic moral economics system, namely the failure of Islamic finance should be moderated. In this new modelling or reorienting "the brand name of Islamic finance [should] emphasize issues of community banking, microfinance, socially responsible investment, and the like" (El-Gamal, 2006: xii). This probably is not something entirely novel; as the very first experience in Egypt was a social bank. Such an institutional solution aiming at correcting and moderating the consequences of Islamic finance will contribute to the development of individual lives by focusing on micro dynamics of the society rather than aiming at affecting the financial equilibrium. In checking the extent to which social banks complement Islamic banks, it is clear that *maslahah* provides the moral standard for social good, and *Shari'ah* requires justice and benevolence.

In reorienting towards Islamic economics' system understanding, "the 'Islamic' in 'Islamic finance' should relate to the social and economic ends of financial transactions, rather than the contract mechanics through which financial ends are achieved" (El-Gamal, 2006: xiii). Thus, as Siddiqi (2004) argues a move towards goals and policy rather mechanistic and legal structure of Islamic finance will serve the human well-being much better. Islamic banking, thus, can provide the "new identity based on substantive and ethical religious tenets" (El-Gamal, 2006: 191).

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