

Islam, Society, and Economic Policy

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“The contemporary Muslim world is still emerging from the long night of colonial hegemony: a period during which the key *institutions of Muslim society* were supplanted and substituted, the moral fibre of society was destroyed, and an ‘unrepresentative’ leadership was groomed to power, producing the most serious schism within Muslim society. *The Muslim society of today is not yet a society on its own.* It is still under the shadow of the Western system and, as such, it is doubtful how ‘representative’ of the Islamic ethos its current behaviour can be.” [Ahmad (1994), p. xiv, emphasis added].

1. INTRODUCTION

The past half century has witnessed the emergence of a vast literature dealing with Islamic economics. The basic requirement of an Islamic economic system is that economic decisions pass through an Islamic moral filter. In essence, an Islamic economy is viewed as “part of the religion of Islam which covers the various branches of life” [Sadr (1982), p. 571]. We know that positive analysis is bounded or constrained by a set of ethical rules; that positive economics is bounded by ethical considerations is not unique in this respect anymore than Islamic economics. The same is true for all economic systems, whether capitalist or socialist. But in the words of Naqvi (1994, p. 2), the challenge facing economic analysis in an Islamic framework is “to show that bringing ethical considerations, which are based on religion, explicitly into the economic calculus in no way fetters the spirit of inquiry”. This is not a simple challenge. The history of scientific and social development indicates that it has been a difficult, if not impossible, task to differentiate between a system of scientific laws and a system of ethical principles [Braithwaite (1950)].

Economic policy must, in the final analysis, deal with an economic system. But any economic system “requires a set of rules, an ideology to justify them, and a conscience in the individual which makes him strive to carry them out” [Robinson (1962), p. 11]. In the case of market capitalism, the prevailing ideology has been portrayed succinctly by Robinson as a system where “values which can be measured

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in terms of money are the only ones that ought to count" (Ibid., p. 141). In materialistic socialism, individuals melt into a collective whole with guaranteed entitlements. Individual motivations and the drive for personal achievement are highly constrained and lack legitimacy in a purely materialistic socialist system. The ethical system of an Islamic society may be placed between these two extremes. It attempts to provide a balance between individual freedom and motivations, and their social obligations.

In all three systems, the role of government and governance is pivotal to system viability and sustainability over time. The recent collapse of the former Soviet Union with its system of materialistic socialism, for example, has been blamed on the inability of the system to produce the type of government and governance that is responsive, adaptive, and efficient. What Marx diagnosed as an inevitable collapse of capitalism because of class contradiction and confrontation seems to have been mirrored in his own materialistic socialist system as a contradiction between government and governance. Democratic governments in market capitalistic societies, on the other hand, have illustrated in practice a large degree of vitality and adaptability but seem indifferent to many of the social ills a free market system creates.

Taming the wild market mechanism, so to speak, by forcing its activities to pass through a moral filter to minimise its negative externalities, such as severe inequalities, the degeneration of social values or the spread of crime and human alienation, while maintaining individual dynamism and achievement, as the system of Islamic economics aspires to do, is clearly a desirable universal goal. However, the application of an economic system based on the Islamic moral filter in the present state of world development, at the dawn of the 20th century, is recent and has not as yet passed the test of time. The applications of Islamic economics are largely in the experimental stage, and there seems to be more than one experiment going on. The present paper attempts to elucidate some of the conditions and factors that shape the development of such experiments, and to illustrate that the issue of maintaining a moral filter is not unique to Islamic economics. It is a universal problem.

The literature on the subject of Islam, society, and economic policy is extensive and wide-ranging.¹ I neither have the capacity nor the space to even begin

¹Fortunately, there have been recent and important contributions to the subject that present both systematic analyses as well as differing views. These include, among others, the work of Ahmad (1976); Naqvi (1994, 1993, 1981, 1981a); Sadr (1982); Nasr (1979); Qutb (1976); Kuran (1994, 1989, 1986); Al-Shakaa (1995); Al-Musawi (1987); Al-Imam (1993); Arrow (1985); Gibb (1968); Gibb and Kramers (1961); Haque (1985); Iqbal and Mirakhor (1987); Khan and Mirakhor (1990); Mawdudi (1976); Nasr (1979); Siddiqi (1981) and the references cited therein. Russell's *Freedom versus Organisation: 1814-1914* (1934) presents an account of the struggle in Western thought during the 19th century that has relevance to the present discussion. Also, Chapter 10 in Russell (1972) presents a concise account of Islamic culture and philosophy. The paper by Khomeini (1969/70), *Islamic Government*, provides the first blueprint, in recent years, for the foundation of an Islamic government in the Islamic Republic of Iran, but this paper has not been widely quoted in the literature

summarising that body of literature. What I intend to do is to give an outline of a basic set of rules that characterises an Islamic social system, the motivational forces that make that system function, and the type of government and governance required to operationally interpret and enforce the rules.

The search for a basic set of rules, that characterises the moral system of Islam and that is logically sufficient to represent the diverse interpretations of Islamic ethical principles, to act as a moral filter and accordingly guide economic policies in Islamic societies, is basic to the present discussion. This is clearly a formidable task that goes beyond the knowledge boundaries of the present author. Fortunately, there are other pioneers in the field. Al-Shakaa (1994) in his classic book on Islam without factions (*Mazahib*) lists and discusses in detail more than twelve major factions in Islamic history and illustrates that although they represent varied views in Islamic government and practice, a common thread cuts across their ideas. The work of Naqvi (1994) is important to this part of the discussion. Developed independently with different objectives and not even quoted in his work, Naqvi (1994) essentially takes Al-Shakaa's tentative argument to its logical conclusion. Aside from his pioneering axiomatic approach, which provides much-needed clarity to the discussion in this field and gives credence and formality to Al-Shakaa's conjecture, it is Naqvi's insistence that Islamic economics be viewed like any other economic doctrine, as "an idealisation of reality, and *relative* to the nature of society" [Naqvi (1994), p. xx], that sets his work apart. The real test of an Islamic economic system is whether or not it "can be implemented and can better tackle specific economic issues. It is essential to leave enough room for discussion and dissent instead of suppressing freedom of thought and expression in the name of religion. For Islam to become the source of a new intellectual paradigm, it should be freed from anachronistic ideas, traditions, and institutions—even those created under the influence of the great *Muslim jurists*." (ibid. xxi, italics added).

The application of economic policies in an Islamic society is further complicated by the lack of a clear definition of the boundaries of an Islamic society. It is not evident how the concept of *Umma* relates to the present-day nation-state. Some recent work attempts a systematic analysis of the role of *Umma* within a social and political framework but leaves out the implications about the sovereignty of the states and the complexity of the present world order of increasingly integrated international economic, social, and political institutions [Ul-Haq (1992)]. The concept of *Umma* adds another dimension to Ahmad's (1994) important observation mentioned in the opening quotation in this paper. The concept of *Umma* presents itself as one of the factors that should be analysed along with the complex socio-economic and political interrelations, both historically and in the present time, between Islamic societies, the West, and the rest of the world. The totality of these factors should have a profound effect on the degrees of freedom that actual Islamic

societies have, in managing their own affairs. In essence, what Ahmad seems to imply is that the development of an Islamic economic system is path-dependent. An Islamic economic system is better studied in the context of an evolutionary system as it interacts with other systems. The concept of *Umma*, or for that matter, any type of allegiance that crosses national boundaries, should complicate the evolutionary process and the prediction of its outcome. The implication of *Umma* to the functioning of an economic system is important but will not be dealt with in great detail. Its complex policy and developmental implications, however, are briefly illustrated in the case of Iran.

In this paper, the Islamic ethical axioms developed by Naqvi and others are used as a point of departure for analysis. Although I believe that that system of ethical axioms captures adequately the main tenets of Islamic ethical values, no attempt is made to evaluate this judgement. Such evaluation is beyond the scope of the present inquiry and, to a large extent, is tangential to its conclusions. Rather, my purpose is to examine whether, given a system of values that enter explicitly into the economic policy framework, it is possible for society to implement such a constrained programme and be able to compete in a highly competitive world environment with accelerating technological change, while maintaining the viability of such an econo-ethical system. It is essential to realise that another given in the scenario is the fact that almost all Islamic countries are in the early stages of economic development. Essentially, I argue that a system of ethical values (axioms) could be maintained by alternative sets of development policies and programmes. Which set of policies is to be adopted depends on its contribution to net welfare. In this view, ethics, policies, and development results form a dynamic interactive system.

As mentioned, the question of how to generate a competitive and growing economy that is constrained by a set of ethical axioms applies more generally than to the case of Islamic economics alone. Indeed, one of the cases referred to in the present paper, Singapore, is not an Islamic country. The other two cases discussed are Iran and Kuwait, both Islamic countries.

The case of Iran was chosen partly to illustrate the problem of the concept of *Umma* and partly to illustrate the role of the international system, especially as they reduce the degrees of freedom for independent action to achieve the harmonious evolution of an Islamic system as envisaged by that society, and partly to illustrate the importance of adaptation within the system.

The case of Kuwait, was selected as an example of an oil-based Islamic society with extreme dependence on the international system. It illustrates the challenges faced by such a society to maintain a balance between its ethical value system and the situation created by a unique resource endowment and extreme dependence on the international system. These special circumstances require an open

exchange of goods, services, and ideas. The moral filter is a hybrid. Initially it was based on a social contract that derives specificity from the country's cultural and religious heritage and its unique resource endowments. But in the course of time, as the country has interacted socially, politically, and economically, the moral filter has evolved into a hybrid, creating concerns as to whether the society is losing its cherished cultural identity. It must be emphasised that the purpose of using Kuwait as an example is neither to examine what brand of Islamic economics the country is implementing nor to compare its ethical filter with that of other countries with similar resource endowments, e.g., Saudi Arabia, Oman, Libya or the United Arab Emirates. Rather, the purpose is to examine, within the special confines of that country's unique resource endowment, the difficulties associated with maintaining an independent system of ethical values, and the internal and external dynamics that evolve and force the evolution of that system's development—a more universal concern.

Singapore provides an example of a non-Islamic society that is faced with the same dilemma. It attempts to balance its own system of ethical values with a national goal of becoming one of the top developed states, joining the sophisticated worlds of international finance and advanced high-tech information and communication. Maintaining such balance requires the imposition of a system of control on the information market, a cost that might reduce Singapore's chances of achieving its goal of becoming a world power in information technology! The case of Singapore illustrates that the challenges facing Islamic economics are not unique to Islamic countries. These challenges are as old as the invention of government and law: are the successes in economic performance and the maintenance of an ethical filter mutually reinforcing?

However, being a sensitive part of the global market and with Islam being viewed as a challenge to Western civilisations, Islamic societies face additional and more serious challenges in maintaining that delicate balance. Islamic societies cannot exist in isolation. The task of catching up with and joining the fast-paced race of continuously moving and highly competitive universal technical society,² where efficiency is supreme, is not accomplished without scarring, some of which could shake the ethical foundations of long-established systems and traditions. Not to join indicates the inability of Islamic economics to function as a viable alternative to the atomistic ethical framework of capitalism. The notion that an Islamic economic system is only meaningful within the matrix of an Islamic system of beliefs and, accordingly, that it will be preferred by Muslims to any other system is not necessarily sufficient proof of its absolute superiority or potential sustainability. Measuring movement inside a room can be done with accuracy by all those present

²By a technical society, not to be confused with a technological society, we mean the presence of a value system that gives prominence to efficiency. A bomb that has more destructive power per unit of output, derives an efficiency value regardless of its social cost or benefit.

inside the room.³ But if the room is a compartment in a moving train or a moving plane, the measurements of movement or progress will vary tremendously depending on whether the observer is located inside or outside the room. Just like that, in today's shrinking world, with mobile technology and universal information, the illusion of progress measured in a closed environment cannot be maintained for long.

What needs scrutiny and careful analysis is the survival probability of the system's value parameters as the system opens up, interacts, and competes with other systems. Experience with systems' chances of survival indicates that they are not independent of their adaptive capacity, their development records, the size and the degree of equity in the distribution of the provision of their entitlement system, and whether such provisions are part of a long-term sustainable development strategy or are designed to gain short-term (or short-sighted) system legitimacy.

2. ON THE FOUNDATION OF ISLAMIC ECONOMICS

Islamic economics is based on the four main pillars that characterise an Islamic society: (1) the ethical value system derived from Islamic principles (*Islamic Bill of Rights and Obligations*); (2) the system's operative rules derived from the ethical system and which serve as the basis for managing the system (*laws and regulations in an Islamic society*); (3) the expected behaviour of the representative microeconomic agents, whether individuals, households or firms, especially with reference to general conformity to the system's ethical principles and operative rules (*the extent of needed enforcement*); and (4) the behaviour of the collective agency of government (*its representation, transparency, and accountability*).

There is a critical fifth dimension to the characterisation of an Islamic economy alluded to earlier, which relates to the definition of an Islamic society. It makes a significant legal and operational difference if that definition refers to a state (country), or to a transnational society (*Umma*). The latter implies a more complex arrangement that could threaten the internal authority and autonomy of countries within and outside the present set of Islamic countries. Thus, the definition of an *Umma* government and its scope of authority and obligations is not clear. However, Muslims all over the world feel a sense of unity. Every day they direct their prayers towards the same destination: Mecca, and regardless of where they are, they may enter any mosque and perform their prayers with fellow Muslims who are otherwise perfect strangers.

Although there is no *Umma* government in the same sense of national governments, the sense of *Umma* seems to be embedded in the conscience of most Muslims. For example, in the early 1970s when oil revenue became a major financial resource in many Islamic countries in the Middle East, there was a movement in

³This is one of the lessons that the theory of relativity contributed to the philosophy of science [Russell (1985)].

Muslim countries to assert that the oil wealth belonged to the *Umma* of Islam and was not to be confined to those who were fortunate enough to have it within their national territorial boundaries; the countries where oil wealth was found had an obligation to share it with their less well-endowed Muslim brothers. The moral/ethical pressure was undoubtedly real and created a flow of direct assistance and preferential employment of expatriates. However, there were no accepted normative or positive economic criteria to regulate such distribution for the benefit of the Islamic *Umma*. Islamic economics at that time was in its formative stage. However, with this sudden large flow of rental wealth, there was no shortage of mainstream development paradigms on the national level. It was an exciting age of planning for national development. Yet development for an *Umma* of Islam was not part of the *Umma's* Islamic economic framework. There was no development paradigm in Islamic economics. The main concern of non-oil countries in the Islamic world, similar to that of many non-oil non-Islamic countries, seems to have been focused on how to share the unearned wealth with those who were privileged to have it. The constituency of *Umma* was much larger than the number of Muslim countries.⁴

It was evident then as now that the concept of *Umma* is real, but it was not clear to me, either then or now, as to what the implications are to a system of Islamic economics, especially if that system's first priority is the promotion of sustainable development in the underdeveloped countries of the Islamic world. The closest contemporary example that resembles *Umma* is that of the Jewish nation. The present structure of the Jewish nation, it has been argued, can be viewed as a multinational or cross-national nation. However, its ability to survive as a multinational nation seems to be based on conditions that differ from those characterising Islam or Christianity. The Jewish nation is very small in size relative to the world's population; it is a relatively closed system with strict membership rules, and has a strongly enforced social contract and network. Furthermore, its constituency members are at the forefront of science and technology. None of these conditions characterise Islamic societies at the present time. As El-Emam (1993, p. 126) observed, the Jewish "*Umma*" is probably the first multinational nation to anticipate the new World

⁴In 1983, at the invitation of the Pakistan Institute of Development Economics, I gave two lectures on *Population Policies*, in which I indicated that the increasing flow of labour migration to the oil countries in the Gulf and the corresponding flow of remittance have both positive and negative consequences to sustainable development in both the sending and the receiving countries. At that time, the positive consequences, mainly short-term, were emphasised while the negative ones, mainly long-term, were minimised. In the discussion period, a participant said with great conviction that he did not see any negative consequences for Pakistan from labour emigration, especially in a period of high unemployment and foreign exchange scarcity. Pakistan, he emphasised, should be thankful to God who put all that wealth in Muslim countries, so that it could be shared as common wealth among Muslim brothers [Sirageldin (1984), p. 28]. It was evident that the idea of *Umma* was deeply rooted in Muslim thought.

System. However, it is not immediately evident whether the Jewish *Umma* will be able to maintain its basic identity and characteristics in the new environment established by changes in the world order. It seems that it must adapt to the inherent conflict between its new status as a Jewish state and inevitable integration into the new world order. The conflict on the individual and state levels should deepen even further via the spread of the super-highway of information technology and the increased international mobility of capital and labour that is moving the world closer and closer towards being truly a global village. Will individuals in various independent countries continue their *Umma* obligations? Or, will the system adapt to an altered moral filter? This fundamental question may be phrased differently: Will the emerging global village be able to accommodate a multicultural, multi-ethical identity?

The Ethical Foundation

The most distinguished characteristic of Islamic economics is the requirement that economic decisions pass through an Islamic moral filter.⁵ One of the main problems in the development of Islamic economics is the lack of agreement as to the dimensions of the moral filter. There must be agreement, or at least a consensus, on the content of an Islamic Bill of Rights and Obligations. The term *obligation* is added to emphasise a fundamental characteristic of an Islamic ethical system. In this respect, the contribution of Naqvi (1994) is seminal. He reduced the basic tenets of Islamic ethics into four axioms, namely:

1. Unity (*Tawhid*): This axiom indicates the vertical dimension of the ethical system. It provides for freedom of action with the view that each individual is viewed as an integral part of the whole. Individuals are trustees of what essentially belongs to God.
2. Equilibrium (*Al'Adl wal Ihsan*): This axiom provides the horizontal dimension of equity. The axiom leaves a lot of freedom for developing policy details, as for example striking an appropriate balance between the needs of the present and future generations.
3. Free Will (*Ikhtiy'ar*): Naqvi (1994, p. 31) explains that individual freedom is being guided by broad guidelines, "but within the frame of these guidelines, careful intellection is required to interpret-reinterpret it within specific societal contexts, and to suit the needs of changing times". Individual behaviour and actions are expected to include social objectives that provide for the general good of the Islamic society and the *Umma*.

⁵Kuran (1994, p. 3) puts the prohibition of interest as the most fundamental of the characteristics of an Islamic economy, followed by *zakat*, and then the moral filter. In the context of the present framework, Kuran's ranking seems to confuse means with ends.

But, these social elements are not compulsory or rigidly set. People in an Islamic society should be able to make such decisions voluntarily. They are not compelled by authority to travel the same path or to arrive at the same destination.

4. Responsibility (*Fardh*): This axiom is closely related to the axiom of Free Will. It follows from the Islamic view that people are God's trustees on earth. Accordingly, they must conserve. The axiom states that there is a social aspect in every asset a Muslim owns or manages. On the other hand, their adherence to responsibility is voluntary. People must make their own decisions and then bear the consequences.

From these ethical axioms, Naqvi derives a set of rules for economic behaviour and policy, the general objective of which is to lead society along a path bounded by Islamic ethics as expounded by the four axioms. The purpose of the set of rules derived from the four basic axioms is to maintain a balance between a person and his/her environment, to achieve a just balance between today's and tomorrow's consumption, and to maintain an equitable distribution of wealth and income. These rules attempt to provide a framework for policy but leave a large domain from which to choose appropriate policy tools, to experiment, and to evaluate the appropriateness of their impact. An Islamic society may set a development objective of increasing per capita welfare. The development objective(s) must not only conform to the four axioms; the policy tools also should not violate these axioms. For example, systems of income transfers or profit sharing are basically tools for policy, the purpose of which may be viewed as the achievement of economic growth objectives subject to the axioms of Unity, Equilibrium, Free Will, and Responsibility. Policy evaluation should consider the outcome of economic policies in the context of their effect on the integrity of the society's ethical system.

The axiomatic system with its derivative rules clarifies the ethical foundation of Islamic economics and provides for a systematic discussion of the subject. However, there are major challenges in translating a value-driven economic policy into practice. Operationally, policy-makers need at their disposal a stable political and legal system that is supported by an elaborate information system able to monitor the results of policy packages. These results need to be evaluated with reference to their narrow economic and wider social and ethical consequences. Some of the required information implies difficult conceptual and measurement problems that could be costly to initiate and maintain, and difficult to interpret if the ethical criteria are not clear or if the interpretation changes over time, or worse yet, if it changes with the changes in government or governance (lack of isonomy).⁶

⁶For the meaning of isonomy and as it relates to democracy, see Hayek (1955).

On Islamic Government

There is disagreement as to what constitutes an optimal Islamic government.⁷ The debate is neither new nor unique to Islamic societies. However, focusing on the historical evolution of Islamic societies does not seem to provide a good guide for an ideal Islamic government.⁸ Going back in Islamic history, the period that resembles most closely the present state of Islamic societies (*Umma*) seems to be that of the Second Abbasid Dynasty (Al-aasr Al-Abbasi Al-thani). The *Umma* of Islam at that time, which comprised different races and with different backgrounds and extended from South and East Asia to Turkey and Spain in the southern parts of Europe, was unified only by the culture and ethical values of Islam, and was disintegrating in both government and ethics.

During that period of history, the vast *Umma* was disintegrating into small non-viable states. The governments of the various states were, on the whole, very corrupt and inefficient, and almost always at war. Rulers of the newly independent states formed alliances with enemies of the *Umma* in their continuous wars among themselves, while they continued to maintain superficial ties with a weak and helpless Khalif to preserve their own legitimacy by being nominally under the banner of the *Umma*. Severe poverty and famine spread through many parts of the *Umma*, while conspicuous consumption prevailed nearby. Some of the horror stories of cannibalism are almost unbelievable, and are most probably exaggerated. There was nothing in the activities or behaviour of state governments of that time that dealt with Equilibrium or Responsibility, for example. This unhappy state of affairs was not necessarily a weakness in ethical values; it was rather a problem of the form of government that evolved and the efficacy of governance that prevailed under the banner of the Islamic *Umma*. But, above all, it was probably a consequence of the absence of a coherent mechanism linking values with a vision of developmental goals and results.

However, in the midst of this almost total collapse of Islamic government(s), basic science and literature flourished. The period, for example, witnessed the birth of Al-Motanabby, Abu-Al-Alaa Al-Meaary and Ibn Al-Ameed, among others, in literature; Avicenna and Al-Farabi in philosophy; and many other noted scholars who

⁷The initial definition of an Islamic government was based on the choice by representation (*mobaiaa*) of a ruler or an Imam who governs according to the application of the principles derived from the Holy Quran and the Sunna (statement or actions of the Prophet). That system included an accepted set of rules that regulated the ruler's and the laity's rights and obligations. It included the embryo of modern constitutional government [Khomeini (1969/70)]. However, this transparent procedure for establishing the rules of government and governance evolved into varied interpretations that went to extremes. Some gave an almost sacred status to the Imam as having absolute authority [Al-Shakaa (1994), pp. 216-232], while others introduced inheritance into the system of government. For more details, see Al-Shakaa (1994) and Al-Musawi (1987) and the references cited therein.

⁸See previous note.

excelled in geography and astronomy [Al Shaka'a (1994); Hussain (1974); Russell (1945)]. Hussain (1974) argues that the flourishing of arts and science in the midst of the declining morality and government was a result of competition among the rulers of the various states of the *Umma* for glory, power, and legitimacy. In spite of the presence of many fertile minds, development in science and ethics did not seem to merge and emerge as a prime engine for sustained economic and political development.

3. ILLUSTRATIONS

Iran

In his *Islamic Government*, Khomeini (1969/1970) makes almost the same point as Ahmad (1994): "The contemporary Muslim world is still emerging from the long night of colonial hegemony". In his foreword, Khomeini states that: "The Governance of Jurisprudence is a clear scientific idea that may require no proof in the sense that whoever knows the laws and beliefs can see its axiomatic nature. But the conditions of the Muslim society, and the conditions of our religious academies in particular, have driven this issue away from the minds [so] that it now needs to be proven again" (p.1). Khomeini's discussion of Islamic government and governance, as well as its duties and obligations, is extensive. It starts by establishing the need to form an Islamic government and continues in great detail on mechanisms, accountability, the role of the *Umma* to reform programmes and the roles of various departments. The Khomeini document apparently became the initial blueprint for the development of an Islamic government in Iran. Its original principles need to be compared with current regulations and practice in order to establish the evolutionary nature of the system and its adaptive qualities.

Iran is a large country—double the size of Turkey—with a population of 64 million in 1993. Iran's economy is based on oil.⁹ More than 60 percent of the central government's revenue comes from oil, and oil constitutes more than 90 percent of the total exports. As in many oil economies, Iran has achieved a high degree of social development, especially in health and education: the infant mortality rate declined from 130 deaths per 1000 live births in 1970 to 35 in 1993, and life expectancy at birth reached 68 years in 1993. Between 1970 and 1992, primary school enrolment rates for both sexes increased from 72 percent to 109 percent (for females from 52 percent to 104 percent), and secondary school enrolment rates increased from 27 percent to 57 percent (for females from 18 percent to 49 percent), while tertiary education tripled between 1980 and 1992, reaching 12 percent. Urbanisation has been growing by 5 percent since 1970, but 47 percent of the population were classified as rural in 1993. Fertility, although declining, is still high with a total fertility rate of 4.9 in 1993 as compared to 6.7 in 1970. The average annual growth

⁹Data in this section are based on that presented in World Bank (1991, 1995 and 1995a).

rate of the population is close to 3 percent per year, and while growth is expected to decline as fertility continues to decline, the present young age structure of the population will guarantee a high rate of growth in the working age population for at least four more decades. It is evident that Iran has been able to achieve a high degree of social development in health and education during the past two decades. I will not get into a debate of whether these social improvements were a continuation of efforts started before the Islamic Revolutionary Regime or have been part of the legitimisation process of the new regime. A recent evaluation of human resources development in the Islamic Republic of Iran indicated that the Revolutionary Regime made remarkable contributions to the health status of various segments of society, instituted a strong family planning programme, and made a serious commitment to basic and higher education for both genders [World Bank (1991)].

Human resources development has also been promoted in similar oil economies. The presence of rental income, and the fact that expenditure on human development, when broadly defined, does not create a conflict with ethical values should facilitate public spending in this sector. However, given the high rate of population growth, maintaining the same level of per capita investment on human resources development should require increasing resources. As oil revenue declines, investments in human resources will be guided more by the expected economic returns on these investments. These returns depend critically on the success of efforts to promote the demand for human resources. Promoting the demand required for the increasing supply of human capital is a necessary condition for sustainable economic development in Iran. In an economically integrated world system, where both capital and labour are mobile, an increase in the demand for national human resources implies increased integration in the world system. The demand for human resources is becoming increasingly globalised and will seek the most efficient labour and an environment that is conducive to foreign investment. Did the introduction of the filter of Islamic ethical rules of conduct to market behaviour promote or constrain economic development? Did the promotion of economic development compromise any of the ethical axioms? Are there external factors that affected the potential for economic development? These are some of the questions that need to be answered in order to assess economic performance in Iran as an example of an Islamic economics.

The answer to the first question is mixed. Between 1980 and 1993, the average annual growth rate of the gross domestic product (GDP), at 2.6 percent, was lower than the rate of population growth. However, during the same period, the growth rates of the agriculture, industry, and manufacturing sectors (4.6, 4.6, and 6.0 percent respectively) exceeded that of population growth. The service sector was almost stagnant, with an average annual growth rate of less than 1 percent, although it employed 46 percent of the labour force in 1986. In 1993, Iran's merchandise exports were valued at US \$16.7 billion, with 93 percent being fuel and minerals (as

compared to 90 percent in 1970), while its imports were valued at \$30.7 billion, with a sizeable proportion going to military equipment that year. The deficit in the country's current account balance increased from US \$507 to US \$3,765 million between 1970 and 1993. Total external debt increased from US \$4.5 to \$20.6 billion between 1980 and 1993. The net present value of external debt as a percent of exports (93 percent oil) increased from 45 percent to 106 percent.

The economic indicators highlighted above do not represent a positive development trend. Some of the apparent difficulties could be related to the freeze on Iran's assets in the West, to the long war with Iraq, and to the embargo imposed by the United States. Other factors could be internal and include the types of economic policies being implemented. It is difficult to assess the relative importance of these factors, given the data at hand. Iran's leadership seems to give more weight to the external factors being responsible for the economic difficulties. This argument may be labelled the "conspiracy argument". The conspiracy argument indicates that a successful development in Iran means the success of an ideology in competition with that of Western atomistic market capitalism. Such success is not acceptable in the present structure of world power. It implies a loss of the surplus that is being extracted by the West from the oil economies and other parts of the developing world. The system of capitalism, in this view, will respond in various ways to defend its present level of net gains in the oil region of the Gulf. In Iran's case, the response was the present policies against Iran. The conspiracy argument indicates further that the issue is not only one of preserving net gains for the atomistic system of capitalism; it goes much deeper as a confrontation between two major civilisations. Without a moral filter to guide market behaviour, the atomistic system of Western market capitalism may need continuous conflict to ensure its internal social unity, legitimacy, and ultimate survival. As a conflict between two major civilisations, the concept of *Umma* comes to the forefront. To Iran, Western capitalism represents itself as an *Umma*. Accordingly, countries like Iran that seek an independent path should expect resistance from it not as individual countries but as an *Umma*. In such circumstances, conflict seems inevitable.

A counter argument could be made that atomistic market capitalism may not need to defend itself. Its most important defence could be the built-in contradictions in the competing systems. This has been the case with the socialist experiment in Eastern Europe and the former USSR. I cannot provide a systemic evaluation of whether or not the presence of the Islamic moral filter in the governance of Iran has adversely affected its economic development potential. Only time, with more elaborate analysis, will tell.

The last question raised above relates to whether or not development efforts in the Islamic Republic of Iran resulted in a divergence from the basic ethical axioms. Some indicators imply a positive move such as the spread of education and improved

health status for males and females, across all segments of society, that should improve intra- and inter-generation equity. However, other indicators are not so positive. Income inequality, measured by the ratio of the income shares of the richest 20 percent and the poorest 20 percent, was worse in Iran than in many countries richer and poorer than Iran, including countries as diverse as Morocco, Egypt, Israel, France and Bangladesh. The poor, as a percentage of the total population, rose from 6 to 9 percent between 1985 and 1990. Although the percentage of the poor is higher in East and South Asia, it did not increase during that period. Again, it is difficult to conclude whether these indicators represent a basic change in philosophy, away from strict adherence to the Islamic ethical axioms of equilibrium and responsibility, or are only a temporal adjustment associated with the nature of development strategy being implemented? Even then, to maintain its stability (isonomy), the ethical filter should indicate how much inequity is allowed in society, as a cost for development, and how the losers will be compensated?

Kuwait

The complexity and the interactive nature of the role of government, the international system, and the structure of society, the basic resource endowments, and the potential development of an Islamic economic system are best illustrated by the examples of some of the Gulf countries. The purpose is to illustrate that the development of an Islamic system of government with its four ethical axioms is not necessarily compatible with the presence of oil that provides a sizable stream of rent for many generations. On the contrary, the presence of a sizable rental income could present an obstacle to reaching an equilibrium between the requirements of the ethical value system and the requirements for sustained economic growth. Some of these issues have been discussed in the case of Iran. Kuwait, however, is a much smaller country and provides a contrast to the case of Singapore.

The oil economies of the Arab Gulf countries have special characteristics of their own. They are small in size but rich in oil. Oil revenue serves as the basis for financing the requirements of economic sustenance and growth. Their economic and social impact far exceed their small size. They have taken an active role in promoting Islamic societies and Islamic economics. For example, Saudi Arabia has developed various centres for the study of Islamic ethics and Islamic economics around the world. Saudi Arabia, being the custodian of the holiest Islamic cities, presents a special and important case-study that deserves an independent analysis all by itself. Other Arab governments in oil economies present Islam as a belief and a means for governance legitimacy. The present discussion will focus on the case of Kuwait. The purpose is to illustrate the conceptual problem, and not to evaluate the empirical context of the country's development planning experience or suggest alternative development scenarios. For these issues, the reader is referred to Sirageldin and Khorshid (1995).

Kuwait is a small country, in both population and area, with large oil reserves. Its revenue from oil exports has far exceeded its absorptive capacity for many years. It was able to generate a vast reserve fund that has been invested abroad. It embarked on an ambitious human resources development programme that provided free health care and education to all its citizens. It has the highest score in the United Nations Human Resources Development Index among all the Arab countries, and has one of the highest scores in the world. It has invested heavily in its infrastructure, and for that purpose imported a large number of expatriate labour that greatly outnumbers its own labour force. On all counts, and excluding the effect of the 1990 Iraqi invasion, based on its social statistics, Kuwait should be a showcase of successful development. It may not qualify as adhering fully to the four ethical axioms underlying Islamic economics, but it should have been a close candidate. It is my view, however, that indicators of development in Kuwait have been somewhat misleading. Many of the indicators do not reveal imbalances that are embedded in the basic structure of the economy. These imbalances have risen to the forefront of the policy agenda in recent years, although they have been clearly signalling their presence for more than a decade. These imbalances include: the emergence of chronic budget deficit, the presence of unemployment among Kuwaiti and expatriate labour, and the mismatch between new entrants to the labour force and labour requirements.

Kuwait has had no shortage of economic advice to help ascertain how to deal with these emerging problems, including advice from the World Bank and the International Monetary Fund, in addition to other distinguished economic and financial consultants and consulting firms. As discussed in Sirageldin and Khorshid (1995), most of the prescriptions have been conventional packages that could have been prescribed to countries with completely different resource endowments and economic structures, say the Sudan, Pakistan, Egypt or Brazil. These policy packages include reducing the size of the public sector through privatisation (which, it is argued, would have the benefit of overall production efficiency) and reducing the public deficit through measures of cost recovery and the reduction of entitlements. These measures seem to be based on an inadequate understanding of the role of government in the context of oil economies, and an inadequate specification of the country's basic developmental needs and priorities. In the context of an oil economy, where oil revenue represents between 80 and 90 percent of the government's revenue, it is the government that, *de facto*, takes the initiative in almost all spheres of socioeconomic activities. The challenge is: How will a government with large size and power be able to complete the necessary development transformation of an oil economy by building a non-oil production base, which essentially reduces its power and control?

The basic developmental challenge, under the condition of the government being the major force in initiating and guiding economic growth, is how to transform the economy away from oil and how to engage the growing labour force in productive, sustainable employment, while maintaining its legitimacy and authority. As will be evident, there are major contradictory forces in play. These forces include the role of the government in such circumstances, the type of democratic participation necessary to legitimise the ethical axioms, and the social contract required to maintain legitimacy, as well as the role of external interests in influencing government behaviour, especially if these interests view oil as being vital to their own development needs and to the survival of their current industrial bases. To establish the link between these complex dynamic forces and the institution of an Islamic economic system, in the case of Kuwait, we need to dig deeper into the structure of Kuwait's economy and its sociopolitical system.¹⁰

As mentioned earlier, Kuwait, like other Gulf countries, is totally dependent on oil for its survival. This pattern of a rental economy, which is familiar by now to those dealing with economic analyses in that region, creates special internal and external political characteristics. These characteristics impede the introduction of necessary reform. For years, the basic development philosophy of Kuwait has been based on the time-honoured tribal code of ethics: of continuously attempting to strike a balance between government legitimacy and citizen entitlements for present and future generations. Entitlements, as part of a generous social contract, have included not only high levels of consumption and human resources development but also employment guarantees. As discussed elsewhere [Sirageldin and Khorshid (1995)], a social contract that is based on a system that guarantees both income and employment, and that continues to depend mainly on the returns of an exhaustive resource base, cannot be sustained for long. It leads inevitably to social and political imbalances and unrest. More obviously, if maintained at the same per capita level of expenditure, it must lead to budget deficit. In the face of high rates of population growth, and in the absence of viable non-oil production, a reduction in entitlements, for the purpose of reducing the deficit, will only postpone the growth of the deficit and the potential collapse of the fiscal system. This is indeed a tautological statement. What does not necessarily follow is the lack of serious development in non-oil production in spite of the apparent achievement in education and health-care. It should be equally evident that privatisation policies or the reduction of the size of the public sector cannot lead to sustainable economic growth under the existing conditions. First, with the exception of service activities such as electricity and water, there is no significant non-oil public production to privatise. Second, the size of the government cannot be reduced as long as non-oil production is not developed. It is evident from the nature of the country's resource endowment that there is no escape

¹⁰For more details, see Sirageldin and Khorshid (1995).

from a sizable and leading role for the government in this early and vital stage of the development transformation in oil economies. The challenge is not to reduce the size of the government. The challenge is rather in redefining the role of government and governance to be able to initiate a true transformation away from oil.

The Role of Government in an Oil Economy

The role of government in an oil economy is fundamentally different from that in other economies. It is the discovery of oil that transforms the role of government into its present status. Oil made the government the employer of society as opposed to being employed by the production base of the society through a true fiscal system, which allows for a viable broad-based system of taxation. Such system can only exist in the presence of sustainable non-oil production. In the absence of such fiscal system, one of the Islamic ethical axioms—mutual responsibility between the government and the governed—becomes conceptually and operationally inoperative. It is possible that such mutual responsibility could exist because of the presence of an enlightened leadership, but it will not have a solid foundation and will lack stability.

Fiscal Policy and Islamic Axioms

With the inevitable rise of the deficit and in the absence of a true tax base, the allocation of dwindling oil revenue among competing needs becomes more difficult and more subject to the power of interest groups rather than the collective good. Another ethical axiom becomes strained—that of responsibility. The allocation of oil revenue may favour the present consumption of existing generations, leading to greater apparent deficit and inter-generational inequity—violating the axiom of equilibrium. The result is another round of policies that attempt to reduce current spending, and thus reduce mutual confidence between the government and the governed. Accordingly, the alliance between the organisational base of the society and the international oil demand establishment becomes increasingly important. Such alliances will attempt to solve short-term disequilibria as opposed to making serious commitments to long-term sustainable development efforts. Postponing long-term reform will make it the more painful to implement.¹¹ Policies attempting to reduce the budget deficit through privatisation or a reduction of entitlements, in the absence of serious efforts to develop non-oil production, will only lead to the development of narrow interest groups and the segmentation of society. The result of reduced entitlements may lead to increased inequality both intra- and inter-generationally, in violation of the basic axioms of Unity and Equilibrium.

It is evident that the role of government is pivotal in promoting a sustained development process in oil economies. The absence of a built-in mutual responsibility makes the government's task even greater and more challenging.

¹¹Zanoyan (1995) examines this dilemma in great details. His conclusions are similar to those presented in Sirageldin and Khorshid (1995) but the policy recommendations are different. The recommendations of the latter focus more on an integrated set of long-term strategies.

Kuwait has been successful in maintaining legitimacy through short-term entitlement measures. It has not succeeded in the development of a long-term policy to develop a sustainable demand for its growing human capital that is independent of the revenue from its non-renewable resource. Thus, it seems difficult to perceive of a set of ethical axioms that could survive in the absence of a competitive and viable production base.

Singapore

The case of Singapore is examined briefly to illustrate that many of the issues discussed in the context of Islamic societies are not unique to these societies. Singapore, an island of three million, has achieved remarkable growth in less than two decades. According to the *World Development Report* of the World Bank (1995), its gross national product (GNP) per capita rose from US\$ 2,880 in 1979 to US\$ 6,620 in 1985, and US\$ 19,850 in 1995. Singapore's per capita GNP in 1995 is slightly larger than that of Kuwait (US\$19,360). Singapore's GNP growth has been one of the highest in the world. It grew by an average annual rate of 8.3 percent between 1970 and 1980, and by 6.5 percent between 1980 and 1993. It is now classified as a high-income country and a high technology and financial centre.

In 1994, Singapore, was ranked as the world's third-largest foreign exchange market, Asia's centre for many derivative products, a regional financial centre for foreign banks and securities firms, and a high-tech manufacturing base for multinational corporations. The country also aspires to become a communications hub for Asia with ESPN, Walt Disney, and HBO locating their Asian headquarters in Singapore. On the high-tech level, Singapore captures more than 70 percent of the disk-drive business in the Asia-Pacific region. Singapore is a haven for high-tech foreign investment. In 1994, it recorded nearly US\$4 billion in contracted manufacturing investments, a 49 percent increase over 1993. Foreign investment is attracted to Singapore because of its efficient English-speaking labour force and top-notch infrastructure [*Business Week* (1995), p. 23].

What is of interest to the present discussion, is that these remarkable gains have been achieved in the presence of tight social and economic controls throughout the recent history of the country. In 1995, Singapore was labelled as being overregulated (Ibid.). These social and economic controls seems to be part of Singapore's cherished ethical system, a system that is embedded in a tightly controlled public education system and an explicit moral code that governs the behaviour of the public sector, the flow of information and, with equal force, private behaviour.

The Cost of the Ethical Value System in Singapore

It has been argued that Singapore could become the world's largest foreign exchange market and the main centre for news broadcasters in the region if it were to

reduce its social control system. In the analyses presented in *Business Week* (1995), it was argued that the existing social and economic control system could not be maintained for long. The system will eventually weaken as the volume of information flowing through the INTERNET increases. It is hard to maintain an ethical filter with this type of technology. The government of Singapore disagrees. Present leaders of Singapore, such as Senior Minister George Yeo, seem determined to maintain the integrity of their ethical value system and to keep out what they see as corrupting Western influences. To them, the social cost of compromising adherence to their ethical axioms will eventually translate into economic loss. Singapore is setting up a neighbourhood police post for the INTERNET. The country, well aware of the efficiency cost of such controls, may never totally release up its system of controls.

Singapore can afford to preserve its ethical value system for two reasons. The first is that the society sees in such controls a benefit that is translated into what they perceive as a more equitable and better quality and style of life. The second is that Singapore's investment in human resource development has been translated into felt material gains. These realised returns enforce the trust in the government and the willingness to pay the apparent cost.

4. CONCLUDING REMARKS

There have been significant advances in the field of Islamic economics both on the conceptual and empirical levels. An important advance is the differentiation between the development of the ethical system as axioms and the derivation of policies. The systems of *zakat* and Islamic banking, for example, are viewed as tools in the context of the higher level of ethical axioms. Such advances are encouraging. They start a productive dialogue with more clarity and objectivity.

Adhering to a system of ethical axioms implies the presence of a social contract that is mutually enforced by both the government and the governed. The stability of the social contract depends, among other things, on the gains realised from its enforcement. This is especially the case since almost all Islamic societies are in the early stages of development. Development in the new economic order implies harsher international competition. The cost of controls should be greater in such an environment and could have unequal presence. Equal opportunities and rewards that are part of the ethical system become a necessary condition in the development of a viable Islamic economic system. Islam could provide a viable ethical filter for atomistic market economies—a system that implies more active government. The economic cost of introducing the ethical filter, nevertheless, must be lower than the perceived benefit to society.

The role of government in the development of Islamic societies varies, depending on context. The existence of an *Umma* government is not clear and could be counter-productive, partly because the concept of *Umma* is not well-defined, and

partly because it is threatening to other sovereign countries. The case of Iran illustrates that potential threat. Islamic governments should focus on building a human resource base that is internationally competitive.

There are Islamic economies that are highly dependent on rental income from oil, an exhaustible resource. In such economies, the role of the government is different. It has a major presence in almost all economic and social spheres, and becomes the main vehicle for development. However, the structure of such economies introduces contradictory elements into the political systems, the mutual enforcement of the ethical axioms, and the relations with the international system. These contradictions make such economies more vulnerable to short-term shocks, but the same contradictions present short-term solutions to issues that require long-term attention. The results, in many instances, reduce the potential for sustainable development and restrain the social contract that exists between the government and the governed. But the potential for sustainable development and the integrity of the social contract are two essential prerequisites for an ethical moral filter to be sustained.

The case of Singapore illustrates that a small society can build itself into an economic world power while maintaining, through strict controls, its own system of ethical values. This is done through long-term investment in human resources, the promotion of a strong anti-corruption value system in both the public and private spheres, a successful economic programme and, above all, mutual trust between the government and the population.

To conclude, an economy with an imposed ethical filter is, to use Meade's terminology, an economy experiencing an enduring or political disequilibrium that is more or less permanent and that can only be maintained by direct control [Machlup (1967), pp. 66-68]. Accordingly, in an economy driven by ethical rules, decisions, whether economic or non-economic, will continue to pass through the ethical filter at a minimum cost to politics and welfare, as long as the system is able to compete favourably with other systems and providing net gains to society and the distribution of these gains are perceived as fair.

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Comments

Islamic economics and conventional economics are quite distinct from each other as Islamic economics is based on the ethical rules of Islam. An Islamic society is characterised by an Islamic ethical system, operative rules derived from the ethical system, and behavioural norms to be observed by individual economic agents and the government.

The study undertakes to discuss the Islamic ethical system and the nature of Islamic government. The current scene of the *Ummah* resembles the period of the Second Abbaseieh Dynasty, when Islamic governments were characterised by corruption, inefficiency, conspicuous consumption co-existing with poverty and famine, and continuous fighting among themselves supported by alliances with the enemies of the *Ummah*.

It is maintained that sustainable development depends on the value-added and on employment in non-oil production sector of the economy. Net productive investment in Muslim countries, like Iran, is very little because of the debt-servicing burden and purchasing of expensive military hardware. In addition, social, economic, and political pressures from internal and external forces impede the success of Islamic economics as it would be a threat to the competing ideology of market capitalism. It is well-known that a complex socio-economic and political inter-relation exists between the Islamic societies and the West which affects the survival probability of an Islamic system as Islamic societies are not allowed to manage their affairs independently. Of course, the viability and sustainability of a system also depends on its jurisdiction, which itself depends on whether an Islamic society is defined as a state or an *Ummah*, and on its ability to deal with specific problems in Islamic societies. The structure of an Islamic society, the role of government, the international system, and the basic endowments for development are discussed in the context of Kuwait in order to understand the difficulties in adhering to the basic tenets of Islamic economics. Despite her well-known achievements in health and education (human resource development), and her vast infrastructure, it is argued, Kuwait *does not qualify for adhering to the ethical axioms* because of the emerging chronic budget deficit, unemployment, and the mismatch between the requirements and qualifications of new entrants into the labour market. Kuwait is alleged to have these problems because Kuwait is a rental, rather than an industrial, economy. However, these problems are a commonplace in most industrial economies which, in fact, lag far behind Kuwait in human development.

The comparison of Kuwait's rental economy with a hypothetical industrial economy suggests that Islamic economies lack democracy due to the absence of accountability; they have an entitlement system for legitimacy, with the present

generation ignoring future generations, and with a chronic budget deficit defined as the difference between the rental income and the net non-oil value-added. This definition of budget deficit and the conclusions assert the superiority of an industrial structure, which, in fact, is not true. Different economic structures, industrial or rental, develop in response to a constellation of endowments available to each country. The economic structure in Kuwait is not a result of any deliberate attempt; rather, it is a consequence of its endowments including oil. Anyway, conclusions drawn in the case of Kuwait cannot be generalised to other Islamic countries with diverse characteristics.

An Islamic ethical system derived by Naqvi,¹ which includes the axioms of unity, equilibrium, free will, and responsibility, is reported to represent an Islamic moral filter² without any personal contribution by the author. To study actual conditions in Kuwait in the context of an "Islamic moral filter", with a view to integrate the Islamic ethical system explicitly with the scientific economic laws, is certainly a formidable challenge. To judge adherence to the ethical axioms derived by Naqvi, it is essential to first show the conditions that would emerge in an economy which follows the Islamic ethical system. Only then can we compare those conditions with the actual conditions prevailing in an Islamic economy—to draw conclusions on the basis of the divergence between them. A mere mention of a few economic problems is not sufficient to declare a judgement regarding adherence to the ethical system. Yet, this is a commendable beginning. More serious research is required to test if the Islamic ethical system presented by Naqvi can withstand reality in various countries.

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¹See Syed Nawab Haider Naqvi (1994) *Islam, Economics and Society*. London: Kegan Paul International; and (1981), *Ethics and Economics: An Islamic Synthesis*. Leicester: The Islamic Foundation.

²For a different discussion in the context of an Islamic moral filter, refer to M. Umer Chapra (1993), *Islam and Economic Development* (Islamabad: International Institute of Islamic Thought and Islamic Research Institute).