

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

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1. 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 in recent years. In this novel and alternative financing method, *Shari'ah* compliance, as a mandatory aspect in terms of legal and mechanical terms, is essential and important. It is also important in a consequential manner that Islamic financing must fulfil the foundational principles and aspirations of Islamic economics. In this particular point, recent developments indicate that Islamic finance is moving in a 'capitalist' direction away from an Islamic economic value system. Therefore, the essentialisation of an Islamic economic system is necessary to assess whether Islamic finance is merely an alternative mode of capitalist production or a unique and egalitarian alternative economic order, which aims to be a 'moral economy', as coined by Tripp [2006].

This paper, thus, is an attempt to discuss the systemic nature of Islamic economics, in which it argues that the modern variant of Islamic economics is a development that began in the 1970s with an alternative system understanding to the existing capitalist modes of production. In this new discourse, Islamic economics held that the capitalist economic order was responsible for the failure of economic development and environmental issues in developing countries. Therefore, it claimed to be an alternative economic system, that, also, owed its development to the emergence of identity politics in the 1970s.

With the rapid development of Islamic finance, research focusing on the foundational base, namely Islamic economics, has been largely ignored. 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.

2. Islamic Economics as a System

Before delving into discussion on the systemic nature of Islamic economics, it is important to define what a 'system' is. A 'system' is defined as the "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 respect, represents the overall order, and within that larger framework Islamic economics, as well as 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. Consequently,

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“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 are fully integrated with its economic motives, 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.

This ‘system’ understanding also relates to the structural nature of an economic worldview regardless whether “theoretically articulated and recorded or traditionally practised over years” [Nomani and Rahnema 1994: 41]. This, then, rejects criticism of an Islamic economic worldview, which is premised on the principles of revealed knowledge. Because, a lack of modern theoreticising does not negate Islamic economics, ‘systemic’ claim, since an 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 been practised or understood in a manner paralleling European notions of economics or Eurocentric expectations. In other words, since the 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 all forms of economic interaction in society. The Islamic order, in other words, through its ethical economic principles 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 [which] represents the testable ground of the system” [Kahf 1989: 43].

The components expected from an economic system, thus, can be located within the Islamic economic understanding. However, in order to justify this statement Gregory and Stuart [1985: 12] rightly argue 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, the Islamic economic systemic construct should consist of the following pivotal characteristics for it to be considered as a system: the organisation of decision-making arrangements; mechanisms for the provision of information and co-ordination; property rights; and incentive mechanism. This paper, however, further elaborates on the characteristics, which can make a viable Islamic economic system. Therefore, in order to talk about ‘systems’ in the 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 proposes 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 economic understanding by revealing the existence of these components in arguing for its systemic nature.

2.1. Islamic Economics: Emergence of Framework Paradigm

In the opinion of the founding fathers of an Islamic economics paradigm, the failure of economic development in the post-independent states of Asia and Africa in 1960s and 1970s was attributed to flawed capitalist economic development strategies, which ignored the importance and centrality of human beings and their well-being. Their objective was, therefore, to develop an economic system understanding as part of the Islamic world order [El-Ghazali 1994]. That would, then, ultimately develop into a human-centric developmental strategy. The Islamic economics paradigm, hence, aimed at the creation of an Islamic system of economics with its distinct values, norms, rules and institutions with a politically oriented systemic understanding as ordained in Islamic order. In other words, Islamic economics aims at a world order, where its ontological and epistemological sources, namely the *Qur'an* and *Sunnah*, determine the framework of the economic value system, the operational dimension of the economy and the economic and financial behavioural norms of the individual Muslims.

The axioms and foundational principles of Islamic economics define the framework in which economic activity takes place within intra-and inter-generational social justice, that, in turn, reveals itself 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 the global dominance of capitalism, which has in reality failed in the economic development process.

In searching rationale for a distinct discipline and system of 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 the everyday life of an ordinary individual, each action is produced and acted through a socially constructed manner, which explains the differences in each realm of life. In a similar manner, “economic systems ... do not function within a vacuum [either]. 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 Rahnama 1994: 43].

This is in accordance with the philosophical foundation of modern social sciences. Therefore,

J. S. Mill, the founder of political economy, referred to different constructions of economic understandings 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 (1995): 55].

Economics and finance, thus, is value-loaded, at its most elementary level and shaped by individual values derived from individual worldview, as part of individual social construct. This, hence, provides the rationale for a distinct economic system. Since factors affecting worldviews differ, different worldviews exist leading to different 'systems' for different peoples. Consequently, an Islamic economic system differs from the prevailing economic systems due to the following:

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

Islamic economics, hence, aims 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 Islamic norms;
- (iv) It describes, analyses, and prescribes, as in the case of other economic systems.

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" [Haneef 2005: 5]. Regarding the place of Islamic finance within this system, it is only the institutional aspect of Islamic economics, which regulates the financing of economic activity in an Islamic framework. As part of systemic understanding, hence, there is a need to have Islamic financial institutions using financial instruments according to rules and regulations of Islam, which are bound by the *Shari'ah*.

2.2. Foundational Axioms and Philosophical Foundations

Having established that Islamic economics is a systemic political economy in nature, in which epistemology, institutions and functions are all interlinked through revealed knowledge. Yet, in order to assess its systemic nature, it is also important to search for the foundational axioms or the philosophical foundations, without which it is not possible to consider 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 micro-foundations of that economy" [Arif 1989: 84].

Leading Islamic economists such as Ahmad [1980; 1994; 2003], Chapra [1992; 2000], El-Ghazali [1994], Naqvi [1981; 1994], Siddiqi [1981], and Sirageldin [2002] have developed an axiomatic approach that forms the conceptual foundations of Islamic economics. These conceptual foundations define an Islamic moral economy and its corresponding ethics as an ideal through which economic and social policies dealing with 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 the Islamic economic system are as follows:

First, the axiom of *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]. This vertical dimension and equality of the Islamic ethical system manifests itself by the inherent equality of each individual as represented by their paralleling proximity to God. *Tawhid*, as the essential part of this economic system, provides for freedom of action whereby each individual is viewed as an integral part of the whole. This principle, 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 idoms provide the framework for economic activity to take place within Islamic norms.

Secondly, the axiom of *Al-'adl wa'l-ihsan* (Equilibrium and Beneficence or 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 2003: 193]. 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 fulfil the needs of individuals, enable them to earn a respectable source of living, develop policies for an equitable distribution of wealth and provide for growth and stability-oriented policies.

Third, the axiom of *Ikhtiyar* (Free-will): In the Islamic economic systemic understanding, humans 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). This, thus, constitutes functional norms of economic activity in Islamic economic system.

Fourth, the axiom of *Fard* (Responsibility): This axiom states that although ‘responsibility’ is

voluntary, individuals and society must recognize their mutual obligations for public good, which stems from the principle of *Tawhid* and, hence, of humanity's vicegerency on earth. In addition, human responsibility towards God, to his/herself and the others in the society implies that "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]. In other words, being a conscious part of a society implies a functional responsibility towards society. Hence, in economic terms, there is a social aspect and responsibility of every asset owned or managed by private or public entities.

Fifth, the axiom of *Rububiyyah*: This as an important axiom in the Islamic economic system that refers to "divine arrangements for nourishment, sustenance and directing things towards their perfection" [Ahmad 1979: 12]. This implies the necessity of sustainable economic growth and development 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.

Sixth, the axiom of *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 *rububiyyah* in an integrated manner, as it directs the individual towards self-development, which leads to economic and social development in harmony with the growth activity that requires purification. In other words, this principle refers to growing in harmony in every aspect of life. "The result of *tazkiyah* is [therefore] *falah*, prosperity in this world and the hereafter" [Ahmad 1994: 20].

Seventh, the axiom of *Khilafah* and human accountability before God: Allah created human beings with the role of being His vicegerent on earth. By this "his (or her) role, position and mission is described as *istikhlaf*, that is fulfilling God's will on earth, promoting what is good, forbidding what is wrong, establishing justice (*'adl*) and promoting beneficence (*ihsan*), resulting in attaining high levels of good life (*hayat al-tayyebah*), both individual and collective" [Ahmad 2003: 193]. Thus, being a vicegerent on earth defines roles, outlines responsibilities and provides the reasons of existence for 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 the principle of *khilafah* include the notion 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. Also, it should be noted, that along with the idea of human accountability before God, or *akhirah*, an Islamic economic system is similarly based on two-dimensional utility function, operating in a positive correlation with each other. For instance, the more social good one does in the temporal world, the more *sawab* or glad tidings one will receive in the hereafter.

Lastly, the *Maqasid al-Shari'ah* or the objectives of *Shari'ah* provides the legal-rationale framework within which Islamic economic activities should be conducted. This final principle aims to interpret the text and restore the principles of Islamic economics in relation to the objectives

of *Shari'ah*. Thus, it implies that the principles of Islamic economics must lead to 'human well-being'. Overall, the objectives of *Shar'iah*, namely the Islamic way of life and code of conduct, are described by al-Ghazali (d. 505 AD) as "to promote 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*)" [Chapra 2000: 118]. In other words, as can be seen, *Maqasid al-Shari'ah* provides the motivation through which economic activity should take place.

Recent re-interpretation of the *maqasid* by Siddiqi [2004] provides a more dynamic understanding to this foundational axiom. Because, the defined objectives of *Shari'ah*, as defined by al-Ghazali, clearly demonstrate individual-oriented objectives without social connotations. On the other hand, Siddiqi [2004] argues that in order to have a properly defined value system for an Islamic moral economy, it is important to examine the nature of the *maqasid*. Moreover, 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" [Siddiqi 2004]. Thus, a dynamic understanding of the *maqasid* offers a better conceptualisation in our contemporary circumstances "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 objective of Islam refers to individual as well as societal considerations beyond the narrow definitional boundaries of Islamic law.

Consequently, each of the aforementioned axioms and foundational principles constitute the micro-foundations or the foundational principles of the Islamic economic system, which are entirely different than the axioms and foundational principles of any other economic 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; Arif 1989] among others).

2.3. Implications of Foundational Axioms

While the axioms and principles previously outlined provide the framework within which the Islamic moral economy operates, they, similarly, have implications for shaping the economic structure in relation to its operational and institutional nature in the Islamic economic system. For instance, the principle of social justice indicates social responsibility and taking care of the needy in society. Consequently, *zakah*, as an economic and social institution 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 1995: 85]. In addition, *rububiyah*, *tazkiyah* and accountability before God, as part of the Islamic micro-foundations, require responsible use of "rightful earnings [by] keeping the

moral purposes of [human beings] in view” [Ul-Haq 1995: 85]. This further implies that earning and production is necessary and good as long as it is conducted with balance, restricts the accepted modes of production and operates 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 1995: 85]. 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 1995: 85]. These examples, consequently, clearly demonstrate how axioms work to produce policies that respond to societal issues by instituting the operational dimensions of Islamic economics.

Likewise, it is important to determine the operational and institutional features of an Islamic economic system as derived from the stated axioms. An Islamic economic system is based on the understanding that societal developments are based on the active motivation of participants in a planned manner by both an individual and collective capacity. This indeed differs from historical materialism, for instance, and therefore, its corresponding development methodology is different than other political and economic ideological standings. Indeed, this difference can only be explained with the vicegerent role given to individuals, who with their free will, are perceived to be active actors of social change. Clearly, according to this analysis, every aspect of economic activity is a result of individual's decision making within the social constraints alongside economic and financial constraints. Hence, Islam provides the framework containing the doctrine, value-judgements and ethics for the functioning of an Islamic economy, where the usual economic and financial choices are made.

In this balanced exchange, each constituent of real life activity is taken into consideration through the axioms stated above in an integrated manner. Therefore, the emergence of the *homo-Islamicus*, with a heart and mind shaped by Islamic values, is expected to motivate that individual to work towards the (enlarged) *maqasid al-Shari'ah* understood as human well-being. As Ahmad [2004: 194] suggests, “change has to be balanced, gradual and evolutionary. Innovation is to be coupled with integration”.

With its ethical foundation and propositions, an Islamic economic system does not deny the existence of self-interest as an important motivation for human action. However, an Islamic moral economy suggests 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 is constraining so that conflict between self-interest and social interest is removed. This framework also draws the line between what is permissible or 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, the Islamic economic system favours private property and private enterprise as the core of economic life as well as the legal foundation of society. However, as in circumstance of self-interest, private ownership is filtered through the moral codes contained in the *Shari'ah* dimension so that individuals understand 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] (see also [Arif 1989: 86]).

As part of the domain of self-interest and private enterprise, the market provides the institutional framework in which economic activity, from production, exchange and division of labour, takes place. Also, the market provides the legal framework for contrast to be fulfilled, which is an essential part of private enterprise enshrined in the Islamic economic system. However, market mechanism is filtered so that social priorities are served alongside individually oriented utility and profit maximising motives [Chapra 2000]. As important, within this Islamically filtered market system “economic efforts take place through the process of co-operation and competition” [Ahmad 2003: 195]. In other words, competition does not allow for the creation of conflict between self-interest and social interest but rather is 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 mechanisms to produce social and economic efficiency simultaneously through the institution of *hisbah* is suggested by Ibn Taymiya [1985]. Thus, a moral filter is suggested to regulate the market. In addition, an Islamic economic system is content with governmental regulatory role to prevent excesses of the market mechanism. Furthermore, to overcome the market and government failure, an Islamic economic system developed *waqf* (voluntary organisations, pious foundations) system as a third sector to serve towards welfare needs of society. Moreover, the Islamic ethical system instituted voluntary instruments such as charity and legal obligations, e.g. *zakah*, to respond to the failures in both the mechanisms so that the needy are provided for. Importantly, filter mechanisms are endowed with systemic instruments that 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]. This is precisely so, because natural resources and the environment is perceived to be an *amanah*, or trust from Allah to humanity. 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 summation, an Islamic economic system, as explained in the preceding sections, aims to guarantee individual liberty, freedom of choice, private property and enterprise, the profit motive, but, in the same instance, provides effective moral filters at different levels of life and activity. Moreover, it establishes its own distinct institutions to fulfil the *Shari'ah* objectives, namely human well-being, economic development and social justice in society. Ibn Khaldun's (15th century)

framework provides a summary of the interdisciplinary dynamic model of an 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-mizan*) 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 does provide the core elements and principals, which form the basic philosophy of a system for 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 the neo-classical/conventional economic system so as to distinguish the Islamic economics methodology, which are as follows:

- (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, the conventional economic system is based on a one-dimensional utility function, which leads to *homo-economicus*—the economic individual in a market system.

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

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

As can be seen Islamic economic system envisages two-dimensional utility function based on the present and the hereafter (due to the accountability axiom) as the reflection of the actions of this

world, leading to *homo-Islamicus*, or as Arif [1989: 92-94] terms it *tab'ay* or an obedient human-being who makes his/her economic decisions, including the allocation of 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 economic 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 worldview does not accept any other source of knowledge other than human, Islamic economics is based on divine knowledge [Khan 1989].

This section clearly demonstrates the distinctive methodology of Islamic economics, which further, strengthen its systemic nature.

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 institutions. As part of its systemic nature, Islamic economics provides institutions, through which economic and financial activity is conducted, with 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 *hisbah* as a regulative institution for the market system.

Overall, Islamic economic and financial activities are shaped by there kinds of measures and institutions.

First, 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 its positive impact on alleviating poverty. In other words, instead of simply giving funds to those economically less fortunate for their immediate consumption, developing projects for the sustainability, survival and continuity of the economically less fortunate is the new strategy with *zakah* funds. *Hisbah* is another important positive institution in the Islamic economic system that regulates the market mechanism by responding to its failures and shortcomings and overcoming its excesses.

Secondly, voluntary measures, such as *sadaqah* (charitable giving), aims at providing the immediate needs of an individual. *Waqf*, or pious foundation, as part of the voluntary third sector, aims to provide the goods and services which either could not be provided for at all or sufficiently due to the failure of the market mechanism or the government. In addition to *awqaf* aiming at providing health services, education, and food distribution etc., the use of funds accumulated in *waqf* in an efficient manner is being developed through cash-*waqf* system and human development projects to enhance their contribution to the economic development of the societies.

Thirdly, prohibitive measures, such as *riba*, which is pre-determined interest, is prohibited,

as it is unlawful gain in terms of not being result of productive economic or financial activity. Islamic economics proposes profit and loss sharing and risk taking and sharing against pre-determined capital gains to motive individuals to actively engage in the economy. The objective of the prohibition of *riba* is not only social justice but also due to achieving economic optimality alongside social optimality with participatory economic objectives.

For this, Islamic financial institutions, in the form of modern banks, have been established since late 1960s that aimed to 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 in 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 operate on a non-interest basis. While it provides Islamic compliant insurance products for individuals and most importantly for business to secure their business and belongings, it also manages funds in an Islamic manner that contributes to economic growth.

All these essential Islamic institutions and instruments aim at enhancing human well being, or the *maqasid*, which constitute the operational dimension of an Islamic economics system. The existence and successful operation of these institutions 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.

3. 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. As an outgrowth of identity politics, the Islamic economic system includes modern institutions and behavioural norms such as the *homo-Islamicus* or *tabaa'ya*. In other words, Islamic economics, with the conceptualisation of *homo-Islamicus*, proposes 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, the 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].

As the discussion in the preceding sections demonstrate, Islamic economics fulfils the prerequisites of a 'system' by having a framework paradigm; a value system; foundational axioms; operational principles/mechanism; a distinctive methodology; and its functional institutions to operationalise its framework. Add to that, a unique value system, axioms, operational principles that work according to its methodology, then it can be rightly argued that Islamic economics 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 the Islamic economic system’s policy orientation 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 that Islamic economics has a system of its own which is distinct from the other hegemonic systems. Thus, the “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 internal hostility from the political machinery to Islam through national governments, and externally, through international pressure, and (d) the adaptability of Islam to new changes in society, technologically and otherwise” [El-Ashker and Wilson 2006: 400]. As El-Ashker and Wilson state that the micro and macro social and political environment must facilitate the functionality of an Islamic economics system. However, since Muslims did not have the necessary global power, they failed to establish their political and, hence, economic order. Therefore, Chapra [1992: 118] himself accepts that “political factor is one of the most important factors responsible for the failure of the Muslim countries to implement *the Islamic strategy for development with justice*.”

The reality of this Islamic economics system based on a particular constructivist ideology is tested by developments that have taken place in Islamic finance, which by forsaking the value system, identity-politics and systemic understanding of Islamic economics and become part of the international financial system. This has serious consequences for the viability of Islamic finance, which is the operational tool of Islamic economics, as in an aspirational sense, Islamic finance is expected to operationalise and fulfil the economic system and moral economic imperatives of Islam. Despite such a system understanding, a critical approach to the development of Islamic finance, however, indicates a very pragmatic development. In other words, since the systemic understanding of Islamic economics could not be achieved in real life, Islamic finance has developed its own working framework that is 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. In other words, “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 Islamic finance to become part of the international financial system, in which it is recognised as heterogeneity 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* by quoting verses in the *Qur'an*. This situation 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 a 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*: *homo-Islamicus* and *homo-economicus* 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 Islamic banks and financial institutions (IBFs) should be restructured to incorporate the authentic appeal to ethics and social justice. On the contrary, they should be perceived as the second best solution, which is a consequence of the inability to achieve the framework provided by an Islamic economic system. IBF institutions, therefore, should remain to respond to the market 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 the current state of Islamic finance as the second-best solution requires new models of development within the authentic notion of Islamic moral economic system. In other words, the failure of Islamic finance should be moderated. In this new model of development 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], namely social banks as experienced in the West. 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 society rather than 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 an 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] by responding to the aspirations of Islamic economic system and the realities of developing economies. Consequently, such a reorientation will operationalise the fundamental axioms and principles of Islamic economic system leading to *falah*, namely “prosperity in this world and the hereafter” by achieving *tazkiyah*, which is “concerned with growth towards perfection through purification of attitudes and relationships” [Ahmad 1994: 20].

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