



REVIVING THE PROMISE OF ISLAMIC ECONOMICS

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ABSTRACT

First generation Islamic economics promised to create a system with just and equitable economic outcomes, which would be far superior to capitalism and communism. Historical circumstances led the second generation to forget this promise, and to consider Islamic Economics as a minor variant of capitalism. The second generation has been trying to create a *sharī'ah* compliant system, where the form is Islamic but the spirit is capitalistic. We need to go back to the roots, and build a genuine Islamic system in form and spirit which is *sharī'ah* based, rather than *sharī'ah* compliant. By doing this, the third generation can revive the promise of Islamic Economics and create a model economic system which fulfills the promise of the first generation.

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1. INTRODUCTION

The Islamic ummah is facing crises of types never before seen in Islamic history. The issue of how Islamic economics should be defined (see Zaman, 2014) remains unresolved. More concretely, how should we organize the economic systems of production and distribution of goods within an Islamic country? How should we organize the financial system? How should we organize the political and educational systems? Due to unique historical circumstances and environment, the ummah has not faced similar questions in the past.

These questions are of critical importance, and the future of the ummah depends on what we will choose together as the answers. It is immediately obvious, and almost universally agreed, that western

systems of thought, and corresponding institutional structures, cannot be adopted without change. The controversies lie in how to change them, and how much to change them. There are two polar positions, neither of which is satisfactory, but it is useful to mention them as a starting point.

On the one hand, there are people who are completely satisfied with the current Western institutional structures. They have no problems with western banking and finance. They argue that the interest of modern banking is not the *ribā* which is prohibited in Islam, so there is no conflict between the two. This issue has been extensively debated and settled among serious scholars, so I will not discuss it further, but assume that we are all agreed that this is an unacceptable position.

On the other hand, there are purists who would like to ban interest, return to gold money, and immediately implement the pure and simple teachings of Islam in all dimensions of life. Specifically, in the economic realm, they are clear that interest is *ḥarām*, and should be stopped. But beyond saying that interest should be banned, they have no idea of how the current economic system works, and what would be the effect of banning interest on this system. They have no genuine alternative system for organizing our economic affairs, so in effect they propose the triviality: *Islamic System = Capitalism – Interest + Zakāt*. As we will explain, this is not a viable equation, because Islam is diametrically opposed to capitalism on many fronts other than interest.

This leads to the current quandary: we cannot accept an interest based system, and simple rejection of interest is not enough to construct an Islamic alternative. What more must be done, in addition to the rejection of interest, to create an Islamic system?

This question, raised in the context of Islamic banking, has its parallels, in all domains of our life. Our political, judicial, economic and social systems are all in need of modification. Modern western systems are directly in conflict with Islamic ideals, and it is unclear how they can be modified to conform to Islamic principles. While many are looking for the key to solve the problem, this article suggests that the key was lost a few decades ago, and we must re-trace our steps in history to find the solutions.

2. THE HISTORICAL CONTEXT

Instead of looking at the path ahead, I propose to look at the historical context. How did we get to this place, where we are facing problems that have never been seen before? Modern banks and currencies take forms which have never before existed in Islamic history, and the question of how we can Islamize them is an issue that has never been discussed by Islamic scholars, so we cannot look to our rich intellectual tradition for answers to these deep and difficult problems. I believe that the problems cannot be solved in the ways currently being attempted because our choices diverged from the correct path earlier in history. There are no solutions in the forward direction. Rather we must re-trace our steps, and move backwards to find the point at which we made a wrong choice in the past.

One of the important sources of our current difficulties is the bifurcation of knowledge into the secular and Islamic. Scholars of Islam, who have spent their lives in studying the *Qur'ān* and *Hadīth* have insufficient knowledge of the intricacies of modern economics. Scholars like myself who have spent their lives in the study of Economics have insufficient knowledge of Islam. It seems to me that deep knowledge of both is required to solve our current problems, but this is very difficult to achieve – in particular, large numbers of wrong answers to current problems have been suggested by scholars with little knowledge of economics, and also by economists with little knowledge of Islam.

3. THE EFFECTS OF COLONIZATION AND IMPERIALISM

At the dawn of the twentieth century, the vast majority of the world Muslim population was under direct or indirect control of European powers. About 90% of the globe was dominated by people of European origins. It is important to understand that this colonialism and imperialism was not just about getting power over people and places. Rather, capitalism is a process for generating wealth. In order to generate wealth, it uses human beings and natural resources as factors in the production process. Indigenous structures of society, political, economic, welfare, educational and everything else were destroyed by the colonizers. Also, we were told that these structures were obsolete, old-fashioned, not functional for modern times, and

that the modern replacements were superior in all respects. In particular structures of taxation and finance were at the core of the capitalist system and these were completely transformed. Also, indigenous institutions for providing health, education, and other social services were completely destroyed so as to destroy the possibility of survival apart from the capitalist system. This is what led to the stark dilemma faced by Muslim leaders all over the Islamic world: On the one hand, we can keep ourselves apart from the capitalist system and starve as Muslims. Alternatively, we can adapt Islam and learn to live together with un-Islamic and anti-Islamic principles of the rulers. Perhaps this is the meaning of the ḥadīth that it will become extremely difficult to live in an Islamic way, and one might have to retire to jungles and caves in order to do so. In many ways, this is very similar to the choices we are facing currently.

It is important to note that a vast network of Islamic institutional structures was either destroyed or bent out of shape. This includes key structures such as *waqf*, *madrasah*, *masjid*, *khilāfah*, *shūrā*, and justice based on *sharī'ah* which are central to Islam. *Waqf* supported free health and education for all, as well as a diverse range of social services. The *madrasahs* provided integrated knowledge of all sciences within a religious framework. The *masjid* was the local center for building community and neighborhood, which are central to the practice of Islam. None of these are performing their functions currently, even though these functions are at the core of an Islamic economy.

Unlike modern institutions, the old institutional structures were Islamic in origin. So one idea would be to go back to these old institutions which were destroyed and replaced. This is a good idea, but requires some caution. Institutions are living structures which are continuously adapting to changing circumstances. For example, there have been three major revisions in international banking regulations in the past three decades – Basel I, II and III. In addition, rules and regulations are almost continuously being changed in response to changing dynamics of international affairs. Our ancient institutional structures were adapted to their environment. Had they survived, they would have changed and evolved to cope with modern situations. So what we are looking for is the shape that they would have had today after a century long process of adaptation and evolution; the old shape

of centuries ago would not suit our needs today. Nonetheless, it can provide a good starting point.

4. LIBERATION STRUGGLES AND ISLAMIC ECONOMICS

The two world wars, which were actually wars between the European powers, caused tremendous damage and destruction. They were among the deadliest conflicts in human history. About 18 million and 60 million people died, mostly young males, in the first and second world war respectively. German women held demonstrations that the Church should allow polygamy, which is permitted in the Bible, due to the shortage of males. The immoral behaviors that we now see in Europe are directly due to shortage of males caused by the world wars, combined with the inflexible stance of the Church on polygamy. But more relevant to our topic is that the weakening of Europe allowed liberation struggles to succeed all over the globe. By the middle of the twentieth century, nearly all of the colonized lands were free of colonial rule.

At that time there were two major systems for organizing economic affairs: capitalism and communism. These rival systems were radically different from each other, engaged in an ideological battle, and each claimed to be the best system. In the struggle for liberation from colonial rule, the question of what economic system should be chosen after freedom was considered by all leaders of revolutions. In the Islamic lands, the liberation struggles were waged in the name of Islam. It was the promise of an Islamic system, far superior to colonial rule, that was used to motivate the masses to give their lives for the cause of freedom. Intellectual leaders of the Islamic world who thought about these issues came to the conclusion that an Islamic economic system would be very different from both capitalism and communism. The subject of Islamic economics was created in the process of sketching an alternative which would provide justice, equity, and prosperity for all. Early writings on Islamic economics which include major figures of Al-Maudūdī and Bāqir Al-Ṣadr, and many minor works, all discuss the defects of capitalism and communism and sketch the broad outlines of an Islamic system. The promise of an independent economic system was part of the struggles for freedom throughout the Islamic world.

However, the dreams of an Islamic system were not realized in the post-colonial period. In fact, the institutional structures in all domains of life remained more or less the same as they were in the colonial period, with only minor changes and modifications. For example, even though the constitution of the Islamic Republic of Pakistan guarantees that there will be no laws repugnant to Islam, this remains merely a writing without any reality. It is important to understand the reasons for this failure.

In order to govern their colonies, it was necessary for the European powers to create an intermediary class:

“We must at present do our best to form a class who may be interpreters between us and the millions whom we govern; a class of persons, Indian in blood and colour, but English in taste, in opinions, in morals, and in intellect.” Macaulay (1935).

This class was called the compradors in Latin America, Black Skins with White Masks (Fanon, 1963) in Africa, and Brown Skins with White Masks (Dabashi, 2011) in Asia. The word “coconut class” is also used informally to denote people who are brown on the outside but white on the inside. This class was given education and privileges, and thousands of members administered the vast empires on behalf of the colonizers. After the end of colonization, this class naturally filled the vacuum and became the ruling class in the Islamic lands and elsewhere. This class was trained to love and respect their colonial masters, and have hatred and contempt for their ancestors, heritage and society. They naturally continued the colonial traditions and institutional structures, and made the minimal concessions necessary to pacify the natives, exactly in line with colonial traditions. This meant that some names and appearances were changed, but there was no movement toward any genuine Islamization.

Efforts to delineate an Islamic system, an alternative to capitalism and communism, were put on the back burner as Islamic groups struggled to wrest political control from these westernized classes. However, colonial powers had ensured the loyalty of the army and the bureaucracy to secular and western ideals, and with these two sources of power firmly in the hands of the coconut class, these political struggles did not succeed anywhere in the Islamic world. The

Ikhwān Al-Muslimīn were defeated in Egypt, just as the Islamic Jamaat-e-Islami was unsuccessful in Pakistan, and similar groups failed all over the Islamic World.

5. SECOND GENERATION ISLAMIC ECONOMICS

The realization of this failure was an essential element in the birth of modern Islamic economics, which is often dated to the First International Conference on Islamic Economics, held in Makkah in 1976. Second generation thinkers were pragmatists, who realized that the revolution requiring radical changes was not forthcoming. Instead of waiting for an unlikely - and perhaps undesirable - revolution, they proposed to work with the existing system. Instead of replacing capitalism, the goal became to change it gradually, and bring it into conformity with Islam. In order to accomplish this goal, it became necessary to study the capitalist system in depth. Vast numbers of second generation Islamic economists acquired western training and degrees in capitalist economics. In the course of their study, they came to believe the western epistemological claims about the nature of economic theory. Three major mistakes were made by most second generation Islamic economists:

1. Failure to understand the spirit of capitalism.
2. Failure to realize that institutions are an embodiment of the spirit.
3. Failure to see through claims that economic theory has the same validity as physical sciences.

Western economic theory has deeply influenced second generation thinking, which still dominates the field, and expresses itself in the current discourse about Islamic economics, finance and banking. Therefore, to understand this thinking, it is essential to analyze modern Western economic thought. Obviously, this enterprise could cover several volumes, but we reduce to the minimum essentials necessary for our current purposes. The main thing to understand is that there was a “Great Transformation” in western thought. Starting from the Biblical position that “Love of money is the root of all evil”, western thinkers came to believe in the opposite, that “lack of money is the root of all evil” (Shaw, 1906). The pursuit of wealth,

accumulation and hoarding were all considered to be evil vices. However, the great transformation changed these vices into virtues, in a process that has been described in detail in Tawney (1926). For a summary of the Great Transformation, see Zaman (2010).

5.1 THE SPIRIT OF CAPITALISM

Weber (1930) has accurately characterized the spirit of a western capitalist society as being the pursuit of wealth as an end in itself: “Man is dominated by the making of money, by acquisition as the ultimate purpose of his life.” He writes that this is irrational, since money should be a means to other ends, and cannot be an end in itself. Nonetheless, it is this spirit which drives capitalism.

Only after the legitimization of the pursuit of wealth and accumulation of money was it possible for institutions to emerge which would satisfy these desires. These are the modern financial institutions, including banks. The evils of encouraging these tendencies were clearly recognized in the early periods of capitalism, though they were later forgotten. For instance, Keynes (1931) wrote that “the accumulation of wealth is ... the most distasteful of human qualities - (a mental disease).” But he said that “For at least another hundred years we must pretend to ourselves and to everyone that fair is foul and foul is fair; for foul is useful and fair is not. Avarice and usury and precaution must be our gods for a little longer still. For only they can lead us out of the tunnel of economic necessity into daylight.”

It is clearly recognized that the love of wealth is disgusting morbidity, but at the same time it must be encouraged, as it will lead to wealth accumulation, which will create heavens on earth. Abandonment of faith in the afterlife and God led to the search for heavens on earth, and it was assumed that the accumulation of wealth was the way to achieve this goal. Therefore, despite moral qualms, this tendency was encouraged and propagated.

5.2 INSTITUTIONS REFLECT SPIRIT

The institutions of a society are reflections of the goals and the spirit of that society; their relationship is like that of the body and the soul. A serious deficiency in current thinking about Islamization of western institutions has been a complete failure to recognize and understand this issue. Banks are the embodiment of the spirit of accumulation of

wealth. They encourage people to save and hoard and multiply wealth. They discourage generosity and giving away. They have never existed in Islamic societies. In contrast, the central financial institution – the place where most excess wealth was placed in Islam, was the *waqf*. The central question is what should be done with excess wealth? In capitalist societies, it is to be accumulated and increased, and the banks provide a means for doing this. In Islamic societies, it is to be spent in the path of God and the *waqf* provides a means for doing this. There are no *waqf* in capitalism just like there are no banks in Islam.

5.3 WESTERN ECONOMICS AS A SCIENCE

An extremely important aspect of western economics is that it claims to be a science, with the same objectivity and factuality. This claim is false, but this is not evident. With such strong evidence of the capabilities of the west on the scientific front, in terms of technological wonders, it is hard to believe that they can make such huge mistakes. I have explained this issue at length in two papers; one is Zaman (2009) on “Origins of Western Social Science”, and the other is Zaman (2013) on “Logical Positivism and Islamic Economics”. The key arguments are briefly presented here. Rejection of Christianity in the West led to the search for alternative sources of knowledge. Science became accepted as the new religion, the only valid source of knowledge, and it was (and is) widely believed that science would provide the solution to all human problems. The term “Social Science” arose as part of the effort to apply the methods of science to the study of humans and societies. This effort has been a complete failure, but this is not realized in the west. The failure of the effort is clear in the breakdown of society, morality, continuous wars, repeated economic crises, and increasing inequality and misery of humankind. If social science had answers to human problems, we would not see so many broken families, divorces, suicides, crimes, and other indicators of unhappiness in the west. Nor would we see a completely unanticipated global financial crisis, if the laws of economics were on par with the laws of physics in their accuracy.

The reason for the failure of social science is simple. The methods of science cannot be applied to the study of human beings, because we are free to choose our paths between good and evil. The past does not predict our future. There are no laws which are invariant

in time and space, which can be used to effectively study our current problems. For a more detailed and in-depth explanation, see Zaman (2015a).

6. THE EFFECTS OF THE THREE MISTAKES OF THE SECOND GENERATION

The claim of western economic theory is that it is just like physical sciences. It is concrete, objective, factual, universally applicable, and does not have any normative elements in it. With few exceptions, Islamic economists who studied western curricula of economics naturally accepted these claims and came to believe in them. The fact that western economic theory is mainly about how we can increase wealth, and that this is a very dubious social goal, was not clear to them. It was presented as an objective requirement for a society, necessary for feeding the poor, and they came to regard it as being in line with Islamic thought.

The first generation of Islamic economists had confidently rejected many ideas presented by western economists. For instance, scarcity is called the fundamental principle of economic theory. The discipline exists because there is scarcity – if everyone could have all that they wanted, there would be no need for economics. First generation economists rejected this idea. There are more than 60 verses of the Qur’ān which mention the limitless bounty of God; for instance, “Behold, God is indeed limitless in His bounty unto man - but most people are ungrateful” (Qur’ān, 2:243). This does not seem compatible with the idea of scarcity. Similarly, the idea that the people do, or should maximize their consumption in this world, does not seem compatible with Islamic principles about consumption in this world, and the Islamic concern for the hereafter. There are many other dimensions of conflict, listed in Zaman (2014, 2015b). In all of these dimensions, the majority of second generation scholars assumed the validity of western economic theory, accepting scarcity, maximization, and a host of other western economic ideas.

6.1 HARMONIZING ISLAM WITH ECONOMICS

Most second generation Islamic economists took western economic theory at its face value as an objective science, with irrefutable, mathematically proven laws. Given this stance, they were forced to

compromise and modify Islamic positions which were in conflict with economic theory. Indeed, there was a substantial amount of passion and vigor in their attempts to harmonize Islam and economics. This is because they often felt that they were defending Islam in this process. Imagine if someone claims that the Qur'ān says that the Earth is the center of the universe, and the sun revolves around it, so that Qur'ān is in direct contradiction with established scientific facts. Sincere Muslims would strive to show that this is not the case, and that the Qur'ān is in harmony with science, so as to defend Islam from the accusation of being obsolete or false. Thus, second generation Islamic economists became a form of “apologetics”, the defense of religion from accusations of errors, or of conflicts with reason. We give a few examples to illustrate this.

Whereas first generation economists had denied scarcity, the second generation saw scarcity as an obvious fact, amply illustrated by the billions of hungry and malnourished people who lack essentials required for existence. Thus, they re-interpreted the verses mentioning the “limitless bounty” of God, and brought in other verses to attest to the presence of scarcity in the teachings of Islam. This is the only approach possible if we accept scarcity as an objective fact, which become necessary if we think Economics is as well established as the modern science of Physics. Other approaches are possible only if we are prepared to contemplate the possibility that economic theory is wrong. Zaman (2012) shows how the apparently objective notion of scarcity actually arises from three different normative principles which have been accepted without mention, and hidden into the frameworks of modern economic theory. The solution lies in noting that God has provided amply and bountifully for our needs, but not for our greed. The economists fail to differentiate between needs and wants, and see their task as fulfillment of even idle desires, which is why they see scarcity where none exists. Islam discourages fulfillments of idle desires. The worship of the *nafs*, forbidden by Islam, but accepted as natural by economists, leads to scarcity where none exists at the level of needs.

Similarly, the fundamental explanatory principle of maximization of utility was also accepted at face value by second generation Islamic economists. Some Quranic verses and *aḥādīth* describe the greed of man, and his love of wealth and worldly possessions. These were taken to show that Islamic teachings and

modern economics were in harmony regarding the behavior of men. Obviously the Islamic view of human behavior is far more complex than that of *homo economicus*. Men behave differently at different stages of their spiritual journey, passing from *nafs al-ammārah*, to *nafs al-lawwāmah* to *nafs al-muṭma'innah*. God says that, “Never will you attain the good [reward] until you spend [in the way of God] from that which you love” (Qur’ān, 3:92). The recommended behavior is the exact opposite of utility maximization – giving away our most cherished possessions would minimize the utility. However, second generation economists ignored all conflicts and stressed harmony in their mistaken belief about the scientific status of economic theories. A popular formula for defining modern Islamic economics became *Islamic Economics = Capitalism + Zakat – Interest*. It was assumed that prohibition of interest was the only difference between capitalism and economics. Islamic economics was just a branch of capitalist economics which studies how interest free economies would function. This was a major misunderstanding which completely ignores the dramatic contradictions between capitalism and Islam which were obvious to the first generation but lost on the second.

6.2 ISLAMIZATION OF WESTERN INSTITUTIONS

This same problem of harmonization which occurred at the conceptual level also occurred at the institutional level. Capitalists asserted that theirs was the best possible social, economic and political system. Accordingly, second generation Islamic economists found that democracy, capitalism, and freedom were the teachings of Islam. In particular, since banking and finance were at the core of a capitalist economy, it became essential to find Islamic analogs for these institutions. This attempt to see capitalism as being more or less identical to Islam blinded the second generation to the true teachings of Islam. We give a few examples to illustrate this.

First, it is important to understand the conflict between markets and society. Experiments show that humans have radically different sets of internalized norms for markets and society. On appeal to social norms, many will gladly volunteer to donate blood, but will refuse to give the same donation for payment. Imagine saying to your mother that you did an excellent job of parenting, and now that I have become wealthy, I would like to pay you back with cash, for these

services that you provided to me! These examples demonstrate the strong conflict between the two sets of norms: social and market.

6.2.1 DIFFERENTIATION OF SOCIAL AND MARKET CONTRACTS

Islam makes a strong distinction between loans and investments. Loans are given purely to help others; these are social transactions, not market transactions. All of the sayings about loans, that we should go easy, provide time, forgive debt, and otherwise provide facilities to the debtors illustrate this social aspect. It is clear that the one who takes a loan does so because of need, and hence his or her position must be weaker than that of the creditor, who has surplus he or she can afford to give. The Islamic form of micro-credit is *qard al-ḥasan*, which is given without expectation of return, as a charity for the sake of God. Debt is in no way a financial instrument, and is also not tradeable under normal circumstances. On the other hand, at the heart of western finance is the trading of debt, and the use of debt as a market instrument. Hodgson (2015) quotes neglected British economist Henry Dunning MacLeod:

“If we were asked—Who made the discovery which has most deeply affected the fortunes of the human race? We think, after full consideration, we might safely answer—The man who first discovered that a Debt is a Saleable Commodity.”

Failure to consider the spirit behind transactions creates problems such as *mushārah* microfinance. If one is providing money as a loan to the poor for social benefits, then one should not be thinking about making profit from this transaction. This is regardless of the issue of *fatwā*, or permissibility in *sharī‘ah*, which may go in other directions. The spirit of Islam is that one should help the poor, and expect reward only from God in return. The *mushārah* transaction is an investment transaction meant for business. It is a market transaction, and not a social transaction. Keeping the two types separate is essential in Islam.

6.2.2 BANKS

Banks are institutions of a type which have never before been seen in Islamic history. Again the problem arises due to mixing of two

legitimate functions. The concept of *amānah*, or safe-keeping for wealth is well-established and goes back to the Prophet (peace be upon him) himself. Thus, narrow banking, or a bank which keeps deposits backed by 100% reserves, and merely provides financial services such as safekeeping, transfers, and checking, would be perfectly fine and lie squarely within the Islamic tradition. However, the idea of gathering money from people who are not actually investors, offering them a small profit, but also ensuring safety (since these are not investors) and then using this money to provide loans to others; this does not exist in Islamic traditions. There are several well-known problems with this approach, one of which is the timing mismatch: banks borrow short and lend long. This leads to regular and recurrent financial crises, which are counted as part of the capitalist system. These problems can be avoided by clearly separating the two functions – deposit banking and investment banking. This would be fully in conformity with Islam, as both of these functions are documented in the life of our Prophet Muḥammad (peace be upon him) himself. Interestingly, after the Great Depression, and more recently after the global financial crisis, many secular economists with no knowledge of Islamic principles have come up with exactly this suggestion for creating a stable financial system. They suggest the need to separate the two functions of safekeeping of deposits and investment banking. Zaman (2015c) shows how the spirit of modern banking conflicts with Islamic values, and how radical re-structuring of institutions is required to create genuine Islamic financial institutions.

6.2.3 SUKUK

Sukuk provide a perfect example of second generation thinking in financial matters. The bond is a familiar western financial instrument of central importance within the capitalist system. The purchaser pays a fixed price, say \$1000 for a bond. In effect, the purchaser is making a loan to the issuer. The issuer pays regular interest on this loan, until a fixed date, at which point the bond matures and the loan must be returned. There is unanimous agreement among scholars that the bond is a pure interest-based instrument and is *ḥarām*. First generation thinkers would have thought that there is some reason for this prohibition. If it is *ḥarām*, then it is harmful, and we should create an economic system which works without bonds. We would need to

examine closely how bonds are used in the capitalist system, and find alternative ways of performing these same functions within Islamic law. In other words, we need to modify the capitalist system, to make it conform to Islamic law.

However, the second generation thinking was different. Since the bond is an essential element of capitalist finance, it was taken for granted that this was a good thing. It therefore became necessary to replicate this instrument within Islamic law. Direct replication was impossible, since it is clearly interest. Therefore, complex indirect methods were found to create something which functions exactly like a bond, but fulfills the formal requirements of Islamic law. Questions about whether or not bonds are needed were not asked, since the optimality and efficiency of capitalist financial systems were taken for granted from the outset. The second generation sought loopholes within Islamic laws to make them accommodate capitalist institutional structures.

6.2.4 INSURANCE

A similar story can be told about Insurance. It was nearly unanimously agreed among Islamic scholars that western methods of insurance involve gambling and *gharar* and are prohibited by Islamic law. An Islamic alternative can be created via a radically different method, based on cooperation. It has to be noted that the radical differences exist in the spirit of the institutions. The western insurance contract is an adversarial contract. The two sides bet with the other and take opposite sides. The gain of one is the loss of the other and vice versa. If an insured event materializes, then the insured party tries to present its losses as high as possible, while the insurer tries to minimize the estimates of damage.

In contrast, *takāful* is a cooperative contract for mutual benefit. People get together and agree to help each other when the need arises. Here the person in need will try to minimize his losses, so as to not be a burden on others. Those wishing to help will try to discover hidden losses and try to help more than the amount requested. Of course this is an idealization, but ideals exert important influence on actuality. There are many ways to implement cooperative insurance ventures, some of which are actually practiced in many areas. For example, in extended families, clans, and family businesses, it is

understood that people will take care of each in times of need. Thus it is feasible to use a cooperative model for *takāful* in the real world; what is required is strengthening of social ties. Creating social ties of love and brotherhood within the ummah is one of the primary goals of Islamic teachings. However, most existing models of *takāful* simply satisfy the formal requirements of Islamic law, without paying any attention to the spirit. In effect, they replicate the adversarial western insurance formats, by using certain complex formats to avoid conflicting with Islamic law. Again, this shows how the second generation searched the books of Fiqh to find ways of accommodating existing western institutions, instead of creating genuine alternatives to western institutions which would conform to plain and simple Islamic laws.

7. THE THIRD WAVE

The idea that economic laws are like the laws of physics, and that western economic institutions are the best possible, was dealt a death blow by the Global Financial Crisis of 2007-8. Physical laws have sufficient accuracy to take rockets to the moon, and to accurately predict eclipses and other astronomical phenomena. Economists could not even forecast the greatest economic crisis of the past century. Even worse, the leading macroeconomic theorists confidently predicted that no crisis would occur, over-riding concerns of practical people who were worried about this possibility. For example, in 2005, Nobel Laureate Robert Lucas proclaimed in his Presidential address to the American Economic Association that economists have solved the most important economic problem, which is the prevention of recessions (cited in Krugman, 2009). Post crisis, another Nobel Laureate, Paul Krugman (2009), suggested that the profession as a whole had gone astray because of overuse of mathematics and underuse of common sense. The Queen of England asked economists at the London School of Economics why no one had forecast the crisis (Andrew, 2008). The U.S. Congress set up a committee to investigate the failure of economics to predict the crisis; see “Building A Science of Economics for the Real World” (2010). Thus, there was widespread acknowledgment of the failures of conventional economic theory, as well as strong evidence that capitalist institutional structures are prone to recurrent and serious failures, causing massive damage to millions.

7.1 AN ALTERNATIVE ECONOMIC THEORY

If we start with the idea that economic theory is fundamentally flawed, it is easy to see that Islam provides a radically different basis for an economic system. Modern economics claims to be an objective description of reality, while in fact it is a normative and prescriptive theory. Economics assumes that everyone acts selfishly to maximize lifetime consumption, without any concern for others. Furthermore, this is rational behavior which leads to optimal outcomes for society as a whole. For example, Nobel Laureate Milton Friedman (2007) vehemently rejected the idea that businesses have social responsibilities and asserted that their only responsibility is to maximize profits, regardless of social costs.

Evidence has accumulated from many different fields of study that the economists' description of human behavior is not empirically accurate. Human beings are naturally inclined to be cooperative and generous, even to the extent of giving their lives to save strangers. Describing competition and greed as natural and rational actually creates these behaviors, so the economists learn to be more selfish than classmates in other disciplines. The global financial crisis was caused by the greedy behavior of the financial industry, which sold mortgages to unqualified people, making profits from a process which wiped out lifetime savings of their customers. Such behavior was enabled and created by standard MBA teachings which place the bottom line above all other considerations.

Instead of a jungle with survival-of-the-fittest as the ideal form of social organization, Islamic economics prescribes generosity and cooperation as the behavioral bases for an ideal world. The Qur'an is full of encouragement to spend generously on others. While economic theory prescriptions of selfishness and competition create such behaviors, ideals of generosity and cooperation also create such behaviors. Throughout the over thousand years of dominance of Islamic civilization, basic needs of the population were recognized to be a social responsibility. Education and health needs were not commodities to be sold in the marketplace to those who could afford it. Rather, society arranged to take care of these needs for all members. Everybody can see the outcome of the competitive jungle of modern economics in the form of stark inequality, misery for billions combined with luxury for a select few. Among many other radical

differences from capitalism, Islam prohibits the concentration of wealth, where the top 8 richest people own more than the bottom half 3.5 billion people on the planet. At the core of Islamic economics is the idea of social responsibility – as a society, we are collectively responsible for the needs of all members, and not just for those who can earn enough money to purchase these needs in the marketplace. There are many other differences, some of which have been spelled out in my paper (Zaman, 2015b) on “Islam Versus Economics.”

7.2 AN ALTERNATIVE INSTITUTIONAL STRUCTURE

Just as Islamic theory is radically different from capitalist economic theory, so the preferred institutional structure of an Islamic economy is radically different from that of a capitalistic economy. In the process of the great transformation in Europe, a battle took place between those who held that money was sterile, and not entitled to earn more money, and others who had the opposite view. The latter view won out, and is now the dominant view in the west. At the root of the western financial systems is the concept of interest, that money is productive and hence is entitled to earn returns. Banks and other financial institutions stay away from real activities and engage in purely financial activities to earn profits. In contrast, Islamic institutions must provide real services in order to earn real returns. In my paper on “Building Genuine Islamic Financial Institutions” (Zaman, 2015c), I have provided a sketch of the financial structure of an Islamic economy. Here, I provide a very brief description.

First, as already remarked, we need to strictly separate institutions for safekeeping deposits, and those for investments. The deposit banks would not provide any loans to anyone, would have 100% reserves, and would provide services such as transfer of money, checking accounts and other standard financial services rendered in connection with money. They would not pay any interest on their accounts. For reasons we cannot discuss here, it should be possible to run an Islamic monetary system with zero inflation. However, if this is not feasible, we could ensure that the deposits are kept in forms which provide hedges against inflation.

The investment banks would provide profits, but also allow for risk of loss. This is in accordance with the Islamic principle of *al-kharāj bi al-ḍamān*; see for example Ahmad et al. (2010). This maxim

of the *shari'ah* implies that money is only entitled to earn a profit if it participates in the risks of business.

Other financial institutions would be oriented toward providing services. One such is Tabung Haji which collects deposits from people planning to go for *hāj* and provides services relevant to *hāj*. Similarly, there could be building societies to facilitate collection and saving of money for house buying, and transport societies to facilitate buying a car and so on. These societies would not just collect money; they would also provide services relevant to their area.

While the above are parallels of key institutions of a capitalist economy, because they cater to consumption, the key institutions of an Islamic economy are the *awqāf*. In the Ottoman Empire one third of the lands were devoted to *waqf*. The Islamic injunctions that excess wealth should be spent on the path of God created the disposition to spend on others. In a society where people are generous, and spend on others, one does not need much income or savings. Thus the capitalist consumer oriented institutions attract less money. At the same time, money is efficiently targeted toward the needy. In Islamic societies of the past, there were no hungry, illiterate or sick people who were in need because they lacked the money to take care of these needs. The challenge for us is to replicate these societies today.

Due to length, details of how we can create and implement in concrete fashion an Islamic system are omitted. These have been discussed in other papers, such as Zaman (2015b, 2015c).

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