



MODERN ECONOMICS AND THE ISLAMIC ALTERNATIVE: DISCIPLINARY EVOLUTION AND CURRENT CRISIS

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ABSTRACT

Mainstream economics has come under scathing criticism from various circles of thought. Within the territory of the discipline, there is a contestation. While one faction (supporters) considers economics a science, engaging with the real world, providing tools for solving fundamental problems to guide policy, another faction (critics) considers it to be under the sway of ideology (of capitalism and free markets) in which arid mathematical formalism is regarded as an end in itself, having no or harmful practical policy implications. Various communities of scholars have emerged that advocate alternative heterodox approaches to the subject, Islamic economics being one among them. In this context the present paper will attempt to provide an account of the recent history of modern economics and shed light on the present state of its crisis. The paper will also attempt to enquire into recent progress and the present state of Islamic economics as an alternative paradigm to mainstream economics. We attempt to answer the question that irrespective of the crisis in mainstream economic thinking, why did the alternative perspective of Islamic economics fail to make a long-lasting mark in academic circles and why did a Kuhnian paradigmatic shift fail to occur within economics? Lastly the paper will point out various theoretical and methodological roots of the present crisis of mainstream economics, which should not be ignored by Islamic economists when formulating the basis of Islamic economics.

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1. SETTING THE CONTEXT AND INTRODUCTION

John Maynard Keynes, in his seminal work, ‘The General Theory of Employment, Interest and Money,’ rightly argues that, “The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else.”¹ This view has grown in credibility and import. The state of economics has enormous practical consequences for human well-being. For instance a sick economy can result in millions of people out of work, with agonizing material and psychological consequences for the job losers and their families. Unhelpful or downright bad advice from economists who have the government’s ear can worsen the problem, or prolong it unnecessarily, or may cause it in the first place. This view was confirmed as reality by the global recession of 2007-08, the recent European debt crisis, surmounting income inequalities across the globe, persistent deprivation and poverty in some parts of world, and so forth. Given this background, the present paper takes a retrospective look at the recent history of mainstream economic thought to shed light on the current state of the discipline. Sections 2 and 3 of this paper will try to unravel both internal dynamics within the discipline as well as factors external to the discipline that were instrumental in shaping its current structure. Section 4 will explain the recent disquiet within the mainstream discipline. Section 5 will explain the recent progress, current state and limitations of Islamic economics as an alternative paradigm to mainstream economics. Section 6 will provide concluding remarks and point out some lessons which should not be ignored by Islamic economists in trying to formulate the basis of the new discipline of Islamic economics.

2. OSCILLATIONS OF A PENDULUM: SMITH TO KEYNES, BACK AND FORTH

The birth of economics as a discipline is usually credited to Adam Smith, who published ‘An Inquiry into the Nature and Causes Wealth of Nations’ in 1776. Smith like other classical economists such as Ricardo, J.B. Say, and so forth, claimed that free markets regulate themselves, hence should be free of any interventions. He referred to the so called invisible hand which meant that the pursuit of self interest is the most important driving force to increase the welfare of the nation and its people. Therefore, according to Smith (1776/1999) the most important incentive for people to produce goods was the income that

they could earn by doing so. A much-quoted sentence from his work reads: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest." A little further on in his book Smith describes this mechanism with his famous metaphor of the invisible hand of the market. Not only the craftsman and laborer but also the capitalist is led in his decisions "by an invisible hand to promote an end which was no part of his intention." Thus, it is by the very pursuit of his own interests that the individual will promote those of society. He also opposed restrictive trade preferences, state grants of monopolies, employers' organizations and trade unions. Government, as explained by Smith, had only three functions: protection against foreign invaders, protection of citizens from wrongs committed against them by other citizens, and building and maintaining public institutions and public works that the private sector could not profitably provide. He argues that "little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes and a tolerable administration of justice; all the rest being brought about by the natural course of things." Classical economists also assumed flexible prices both in the case of goods and wages and believed in Say's law which maintained that supply creates its own demand. Say's law was interpreted by classical economists that there could be no overproduction in a market, and that there would always be a balance between supply and demand. Following the flexibility of prices and Say's law, the economic cycle was seen as self-correcting, government was not supposed to intervene in the economy (actively), during periods of economic hardship because it was seen as futile. Classical economics assumed flexible prices both in the case of goods and wages.

Neoclassical (named after the late-19th-century theorists who elaborated on the concepts of their 'classical' predecessors) economics was founded on the notion of *homo economicus*, an anthropological construct that itself was based on three basic axioms: atomism, egoism, and subjective rationality. Atomism means that the economic agent is an individual whose preferences are formed without the external influence of other individuals' preferences, cultural models, advertising, and so forth. Egoism means that individuals are moved by personal aims for their own welfare. Subjective rationality implies that the economic agent is gifted with perfect and complete knowledge, an unlimited capacity for calculation and the ability to find the best means of achieving his or her ends. The neoclassical approach tried to show that an ideal social order is a general economic equilibrium that can

be achieved through the simple unconditioned interactions of a set of social atoms that are both egoistic and rational. These interactions take place in the market and consequently the ideal social order is market equilibrium. Thus, as in classical economics, the basic presumption of 'neoclassical' economics was faith in the market system (Screpanti and Zamagni, 2005)

Boettke and Horwitz (2005) talk of three important developments in 20th century economic thought and history that completely changed the perception about the free markets and state intervention: (i) formalism and positivism in economics; (ii) the Bolshevik revolution and the rise of socialism; and (iii) the Keynesian revolution in macroeconomics and the rise of international policy institutions grounded in that revolution.

They are of the view that each of these three shifted attention away from the appropriate institutional structure of good governance to the necessary activities that government must undertake – a move from designing rules to direct action. They maintain that while positivism contributed in the shift away from institutions by delegitimizing the study of ideology as an important component in social theory, the formalism directed economists' attention away from how the institutional structure of society directed actors to behave in directions more or less conducive to economic development. The combination of the formalistic preoccupation with equilibrium properties and positivistic disregard for ideas meant that the sort of questions that dominated the discussion of the wealth and poverty of nations from Smith to Weber were pushed aside in the field of political economy². Secondly at the time when western democracies were trapped in the crisis of the great depression and the Soviet system seemed to avoid the problem through rational central planning of the economy. However, the most important of the three was the Keynesian revolution.

The faith in the free markets was shattered by the Great Depression. John Maynard Keynes tried to provide both an explanation of what had happened and a solution to future depressions in his 1936 masterwork, 'The General Theory of Employment, Interest and Money,' in which he proposed a theory to fix capitalism (not to replace it). But he did challenge the notion that free-market economies can function without a watch out and he called for active government intervention printing more money and, if necessary, spending heavily on public works to fight unemployment during slumps (Krugman, 2009). Keynes' ideas became widely accepted after the Second World War, and until the early 1970s, Keynesian economics provided the

main inspiration for economic policy makers in Western industrialized countries. Governments prepared high quality economic statistics on an ongoing basis and tried to base their policies on the Keynesian theory that had become the norm. During this phase most western capitalist countries enjoyed low, stable unemployment and modest inflation, an era called the Golden Age of Capitalism.

However not all economists accepted the Keynesian views and one of the most important thinkers among them was Chicago school economist Milton Friedman. The neoclassical revival was initially led by Milton Friedman of the University of Chicago, who asserted as early as 1953 that neoclassical economics works well enough as a description of the way the economy actually functions to be “both extremely fruitful and deserving of much confidence.” Friedman’s counterattack against Keynes began with the doctrine known as monetarism. Monetarists did not disagree in principle with the idea that a market economy needs deliberate stabilization. “We are all Keynesians now,” Friedman once said, although he later claimed he was quoted out of context³. Monetarists asserted, however, that a very limited, restricted form of government intervention, namely, instructing central banks to keep the nation’s money supply, the sum of cash in circulation and bank deposits, growing on a steady path was all that was required to prevent depressions. Friedman and Schwartz in their book, ‘A Monetary History of the United States, 1861-1960’ in 1960 gave a significant argument that the great depression of 1929-32 had occurred, not because monetary policy could do nothing, but because the Federal Reserve had taken a disastrous decision of tight monetary policy in the early 1930s, allowing the money supply to fall catastrophically (Backhouse, 2010; Bullock, 2009). Even when many economists and historians questioned this account, it provided a clear and very powerful alternative to the Keynesian view that slumps originated in the private sector, and that key to the Depression was a collapse in investment (Backhouse, 2010).

With the oil shock of 1973, and the economic problems of the 1970s, Keynesian economics began to fall out of favor. During this time, many economies experienced high and rising unemployment, coupled with high and rising inflation. Keynes’ ideas had always been understood to be able to handle either inflation or unemployment. If the economy slowed and the unemployment rate rises, then according to Keynesianism, stimulus was in line. If the economy was overheating and inflation was rising, then Keynesianism suggested tightening of the policy to dampen the economy. This stagflation meant that the simultaneous application of expansionary (anti-

recession) and contractionary (anti-inflation) policies appeared to be necessary. This dilemma led to the end of the Keynesian near-consensus of the 1960s, and the rise throughout the 1970s of ideas based upon more classical analysis, including monetarism first and later on by the free market economics. At the same time, the evidence also appeared to support an argument Friedman had made very publicly in his presidential address to the American Economic Association (AEA) in 1967 and published in 1968, namely, that there was a 'natural rate' of unemployment, and if policy makers aimed for a rate above this, inflation would accelerate because rising inflation would raise expectations of inflation, causing inflation to rise still further⁴. Unemployment was simply not a variable that the government could control, reinforcing his argument that policy should be directed at the growth rate of the money supply⁵.

Not only Friedman, there were other academic critics of Keynesianism whose ideas of *laissez-faireism* were getting influential in the 1980s—they were Robert Lucas, E.S. Phelps, Thomas Sargeant, Neil Wallace and others. Using complicated statistical and mathematical models, these theorists asserted that the government efforts to improve economic performance would normally have the opposite effect. In 1969, Edmund Phelps brought together a group of economists who were all working on the problem of how prices, wages, output and employment would behave when there was incomplete information, which culminated in the volume titled 'Microeconomic Foundations of Employment and Inflation Theory' in 1970. Lucas along with Leonard Rapping contributed a chapter in this book that laid out a labor market model that they then fitted to U.S. data. When confronted with imperfect information, the workers in these models would sometimes make mistakes and end up being unemployed. The main feature of their model was that unemployment was a result of workers' choices and therefore voluntary. In this model, unemployed workers were 'persons who regard the wage rates at which they could currently be employed as temporarily low, and who therefore choose to wait or search for improved conditions rather than to invest in moving or changing their occupation'. This idea, that unemployment should be modeled as voluntary, was developed into a full-fledged theory in which fluctuations in output were caused purely by errors in expectations: if everyone correctly anticipated the future, markets would be in equilibrium with supply and demand, and there would be full employment. Lucas (and other advocates of *laissez faire*) then combined this theory with the idea of 'rational expectations' to develop what came to be called the 'New Classical

Macroeconomics' (NCM). Earlier Friedman (by following Philip Cagan) assumed adaptive expectations, a kind of inflationary expectation formed in a rather mechanical way by extrapolating from past experience. Lucas adopted 'rational expectations'— a hypothesis that had already been formulated in 1961 by J.F. Muth in an article published in *Econometrica*, titled 'Rational Expectations and the Theory of Price Movements'. The main problem with adaptive expectations is that they are unable to deal with all the available information in a rational way. For instance, the formulation process of adaptive expectations only takes into consideration past experience; the agent who follows it simply ignores the policy announcements and the future effects of current economic policies. Rational expectations are formed on the basis of all available information by taking into account the previous experience as well as future effects of current policies. Thus according to Lucas, if people used a certain rule for forecasting inflation and if that rule generates forecasts that are systematically wrong, people will realize it and modify their forecasting rule. A rational forecast is therefore one that generates expectations that differ from what is observed only through random, unpredictable errors.

In 'Expectations and the Neutrality of Money' published in 1972, Lucas combined these different ideas to produce a model with dramatic implications. The only cause of fluctuations in unemployment, in his model, was unpredictable monetary policy because this would cause people to make mistakes, thereby generating short-term fluctuations in output and employment (Backhouse, 2010). This provided a much stronger reason for opposing government intervention than anything Friedman and the monetarists had provided. Lucas argued that recessions were caused by temporary confusion: workers and companies had trouble distinguishing overall changes in the level of prices because of inflation or deflation from changes in their own particular business situation. Lucas warned that any attempt to fight the business cycle would be counterproductive: activist policies, he argued, would just add to the confusion (Krugman, 2009).

According to NCM or Neo-monetarism, the business cycles are driven by unexpected exogenous monetary shocks based on incomplete information. However this conception was soon critiqued because it only accounts for short and chaotic movements of economic variables and not business cycles as such⁶. In response to this problem, two distinct strands of literature in the form of 'Real Business Cycle' (RBC) and 'New Keynesian Economics'(NKE) emerged. The RBC

theorists accepted the basics of the NCM approach including rational expectations, to postulate that the shocks that drove the business cycle were ‘real’ shocks, involving random changes in the growth rate of productivity⁷ (Stadler, 1994). In these models unemployment is a deliberate decision by workers to take time off and hence a voluntary phenomenon (Backhouse, 2010). On the other hand, NKE generally accepted the idea of rational expectations but emphasized the importance of imperfect competition, price and wage stickiness, asymmetric information as the predominant impulse mechanism (Stadler, 1994). NKE showed that irrespective of rational expectations, Keynesian phenomenon might still emerge; the economy may fail to attain full-employment. Yet they kept deviations from neoclassical orthodoxy as limited as possible. From the 1980s till 2007-08 the work of these laissez faire economists dominated the profession to the extent that it was no longer necessary to speak of Keynes in discussions of policy. Most of these models (including in NKE⁸) kept very little (or no) space for things such as bubbles and banking system collapses (Krugman, 2009). Even when these things were happening continuously (Asian economic crisis 1997-98, depression level slump in Argentina in 2002) most of the economic theorists were unwilling to reflect on them (Krugman, 2009). Finally when the 2007-2008 Recession created havoc, Keynes came back into relevance. Krugman (2008) argues that we are living in a new era of depression economics and Keynes-the economist who made sense of the Great Depression was more relevant than ever⁹.

3. RISE OF FREE MARKET: THE INFLUENCE OF IDEOLOGY OR THE QUEST FOR SCIENTIFICITY

After the end of the Second World War, the state forms were restructured to prevent a return of the catastrophic conditions that led to the great depression of the 1930s. There was a broad consensus for the need of mixed economy (outside the Soviet bloc); there was wide acceptance of the principle that the state should have a presence in economic activity. Although there was some opposition to this consensus, both within and without academia, yet this movement remained on the margins of both policy and academic influence until the troubled years of the 1970s (Harvey, 2011). From the 1970s onwards there was increased prominence of free market economics or ‘Neoliberalism’ – a vigorous championing of free markets, accompanied by admonition of government interference (Backhouse, 2010). There was greater openness of economists to free market

solutions and also a greater prominence of economists who were hostile to government intervention. The question is what led to the dramatic and remarkable shift in the attitude toward state intervention in economic activity? Apart from the changes that were taking place within the discipline at the level of construction of rigorous theoretical models (discussed in the previous section), a web of factors outside the disciplinary boundaries of economics had augmented this shift.

There were a lot of well networked and well funded think tanks, which nurtured the ideology of free markets and were persistently pushing their ideals within academia as well as in public policy. Having a retrospective look at the institutionalization of free market ideals, one finds first such systematic formulation in the Mont Pelerin Society (MPS)¹⁰. Founded by F.V. Hayek in 1947, the society attracted likeminded intellectuals committed to strengthening the principle and practice of a 'free society' by studying the working and virtues of market oriented economic systems (Plehwe and Walpen, 2006; Steger and Roy, 2010). The MPS vowed to stem what they saw as the 'rising tide of collectivism', be it Marxism or even less radical forms of state intervention. The aim of the MPS was not to exert an immediate pressure on policy but to have a long term influence on the climate of opinion. Although many prominent economists such as Milton Friedman were members of the MPS, Hayek was the most dominant figure of MPS because of his book, 'The Road to Serfdom' in 1944. He was a great believer in free markets, and considered most state intervention on the economy as worrying milestones on the 'road to serfdom' leading to new forms of government engineered despotism. Despite its appearance as a mere intellectual meeting place, the MPS actually acted as an ultimate Trojan horse for neoliberal thought, because it became the center of a worldwide network that included individuals and organizations concerned with sponsoring free-market ideas, think tanks and academic economists, including many who were either members of the Chicago School or had been trained in Chicago¹¹.

Immediately after the establishment of the MPS, there was a mushrooming of other associations and think tanks propagating free market ideals. While Hayek was preparing for the initial meeting of the MPS, he was approached by a successful chicken farmer, who had recently read 'The Road to Serfdom' and wanted advice about influencing public policy for the 'better'. He was elected to the MPS in 1954, and turned to be a free market think-tank breeder. In 1955 he founded the Institute of Economic Affairs (IEA) in London. Although IEA was registered as a charity, formally apolitical, it published a

series of pamphlets and books by academics as well as journalists advancing ideas of liberalization, marketization and privatization of economies, to influence the government policies. In the U.K. the IEA exerted a strong influence on the Conservative party under Margaret Thatcher, and was sometimes termed as the ‘Thatcher’s think-tank’. IEA spawned a dozen of think tanks (including Atlas Network¹² established in 1981), that mostly function as fronts for the MPS. Edwin Feulner (MPS member) emulated Fisher in the U.S. and established the Heritage Foundation in 1973, which became much established in the policy making process during Ronald Reagan’s presidency.

Even though many MPS members became influential in economics (like Friedman, Hayek, Gary Becker, George Stigler, etc.), the changes in such a think-tank landscape were impacting academic economics indirectly. The more direct impact on economics came through the channels of funding institutes, in the context of the Cold War. The linkages between different institutions, the Cold War, and discipline of economics have been discussed at length by Amadae (2003), Backhouse (2008, 2010) and Mirowski (2002). Mirowski (2002) argues that under the guidance of the government/military and through the institutions such as RAND Corporation, Cowles Commission, Ford Foundation, and so forth, Economics underwent a paradigmatic shift bluntly described in the subtitle of the book ‘Machine Dreams: Economics becomes a Cyborg Science’¹³. This (for him) was manifested in the shift of focus from economics being a study of “the optimal allocation of scarce resources to given ends” to a study of “the economic agent as a processor of information”. The military sought to manage scientific research with its broader mantra of “command, control, communication and information” (an imperative quite obvious in the Cold War context). Thus, according to Mirowski the military was responsible for reorganization of scientific organizations in America and the design of research programs in economics. Mirowski (2002) stresses the role of computers and the potentially intelligent machines as both inspiration and tool of the *cyborg* sciences. Although economists were reluctant to abandon classical mechanics as their conceptual template in favor of a new paradigm grounded in computer science, they could not ignore important developments in the information sciences that had ramifications for economics. For Mirowski the resulting tension shaped economics throughout the second half of the 20th century. His main argument is that the focus of scientific research shifted towards *cyborg* sciences, which drafted economics into them and remade

economic orthodoxy in their own image¹⁴. At the center of this story there is the demigod figure of von Neumann, a mathematician, who made a fertile detour in the discipline of economics through his book 'Theory of Games and Economic Behaviour' (co-authored with Oskar Morgenstern). Besides portraying him as central figure of scientific revolution, Mirowski also stresses his links to the military and his role in the design and organization of research, to make him "the single most important figure in the development of economics in twentieth century".

Backhouse (2008, 2010) also traces the ways in which different institutions of the profession interacted (especially through funding channels) with the content of economics to produce a discipline dominated by techniques, and how foundations of orthodoxy were laid, wherein encouragement was given to certain types of theorizing and certain types of empirical work. Backhouse (2008) argues that the Second World War was more than a conventional dividing line, for it (and the immediate Cold War) affected the course of economics. According to him the interwar period had been one of pluralism within economics wherein different approaches to the subject were competing with each other, none of them being dominant. Within a few decades this changed to pave the way to more technical and more orthodox economics. While covering this change he focuses on the funding agencies such as the RAND Corporation (a think tank established by the U.S. Air Force devoted to fighting the Cold War); and other philanthropic foundations like Ford, Rockefeller and Carnegie which were the major players in shaping social sciences (especially economics) to consolidate U.S. influence in the world. According to Backhouse (2010) one of the clearest and most important illustrations of the link between defence funding and economics was the RAND. In the 1950s RAND developed close ties with the Ford Foundation and soon focussed on 'System Analysis', which denoted the techniques that could be used for efficient management within either private firms or the state. The managerial paradigm of Systems Analysis was based on the rational choice theory, which was central to the work of RAND since its inception. This according to Amadae (2003) had a clear ideological use, since it provided the ideological framework for opposing communism. The rational independent individual could be contrasted with the collective actions of the Soviet State. Similarly the most important research on game theory was also carried out at RAND, because of its perceived value in developing military strategy.

Thus it is clear that many factors outside the boundaries of the discipline shaped the course of economics and the nurturing of economic research by many institutions was a conscious attempt to impose an ideological agenda on economics. Regarding the Rational Expectations models, Stiglitz (2002) observed that:

“such models prevailed, especially in America’s graduate schools, despite evidence to the contrary, bears testimony to a triumph of ideology over science.... the rational expectations models made an important contribution to economics; the rigour which its supporters imposed on economic thinking helped expose the weaknesses underlying many hypotheses. Good science recognises its limitations, but the prophets of rational expectations have usually shown no such modesty.”

However Backhouse (2010) adds a word of caution by arguing that even though one might argue that ideology can hardly have been absent from institutions devoted to fighting the Cold War (like RAND), the emphasis was also on treating economic and social problems as being technical, amenable to rational analysis of evidence. He argues that Economics changed so profoundly because ideological and methodological pressures¹⁵ were moving in the same direction.

4. PRESENT STATE OF CRISIS IN MAINSTREAM ECONOMICS¹⁶

In 2003 Robert Lucas, gave the presidential address at the annual meeting of the American Economic Association. After explaining that macroeconomics began as a response to the Great Depression, he declared that it was time for the field to move on: the “central problem of depression-prevention,” he proclaimed, “has been solved, for all practical purposes.” Lucas was not alone in claiming that depression prevention was a solved problem. A year later Ben Bernanke (2004), the Fed Chairman, gave a cheery speech titled ‘The Great Moderation,’ in which he argues, much as Lucas had, that modern macroeconomic policy had solved the problem of the business cycle or, more precisely, reduced the problem to the point that it was more of a nuisance than a fundamental issue. Thus, in a 2008 paper titled ‘The State of Macro’ (that is, macroeconomics, the study of big-picture issues such as recessions), Olivier Blanchard of MIT, now the chief economist at the IMF, declared that “the state of macro is good.”

The battles of yesteryear, he said, were over, and there had been a “broad convergence of vision.”

During the same years the image of economics presented to the public was that of a discipline that was not just successful but also overflowing with confidence. According to some of the most popular books of the time, economics was about the “life, the universe and everything”(Chang, 2014) as the titles of the books revealed¹⁷: ‘Everlasting Light Bulbs: How Economics Illuminates the World’(Kay and Beale, 2004); ‘Freakonomics: A Rogue Economist Explains The Hidden Side Of Everything’ (Levitt and Dubner, 2006); ‘More Sex Is Safer Sex: The Unconventional Wisdom Of Economics’ (Landsburg, 2008); The ‘Logic Of Life: The New Economics Of Everything’(Harford, 2008); ‘The Economic Naturalist: Why Economics Explains Almost Everything’ (Frank, 2008). Among these *Freakonomics* was a bestseller and by 2009 sold over 4million copies worldwide.

This over-optimism was shattered into pieces by the Great Recession of 2008. In the Great Recession millions of people in America and all over the world lost their homes and jobs. A crisis that began in America soon turned global, as tens of millions lost their jobs worldwide (20 million in China alone) and tens of millions fell into poverty. The Great Recession was clearly the worst downturn since the Great Depression seventy-five years earlier (Stiglitz, 2010).

The recession showed all the promises made by the free market economists turned out to be false. The belief system that was a quarter century old like free and unfettered markets are efficient (if they make mistakes, they quickly correct them), the best government is a small government, and regulation only impedes innovation and central banks should be independent and only focus on keeping inflation low, were completely dismantled by the recession. Not only the economists but various journalists became critical about the notions of the free market but also the economic discipline itself. It will be evident by mentioning titles of some books and articles: ‘Slapped by the Invisible Hand’ (Gorton, 2010), ‘Erasing the Invisible Hand: Essays on an Elusive and Misused Concept in Economics’ (Samuels, 2011), ‘There is No Invisible Hand’ (Schlefer, 2012) and ‘Beyond the Invisible Hand: Groundwork for a New Economics’ (Basu, 2010). Similarly, after a weeklong workshop, one group of economists released a paper titled ‘The Financial Crisis and the Systemic Failure of Academic Economics’ (Colander et al., 2008) which was highly critical of their own discipline unethical use of

unrealistic models. Their abstract offers an indictment of fundamental practices:

“The economics profession appears to have been unaware of the long build-up to the current worldwide financial crisis and to have significantly underestimated its dimensions once it started to unfold. In our view, this lack of understanding is due to a misallocation of research efforts in economics. We trace the deeper roots of this failure to the profession’s focus on models that, by design, disregard key elements driving outcomes in real-world markets. The economics profession has failed in communicating the limitations, weaknesses, and even dangers of its preferred models to the public. This state of affairs makes clear the need for a major reorientation of focus in the research economists undertake, as well as for the establishment of an ethical code that would ask economists to understand and communicate the limitations and potential misuses of their models.” (Colander et al., 2008)

According to Krugman (2009), “The economics profession went astray because economists, as a group, mistook beauty, clad in impressive-looking mathematics, for truth.” Stiglitz’s (2010) views are also very close to Krugman when he points out that:

“As we peel back the layers of “what went wrong,” we cannot escape looking at the economics profession. Of course, not all economists joined in the jubilation of free market economics; not all were disciples of Milton Friedman. A surprisingly large fraction, though, leaned in that direction. Not only was their advice flawed; they failed in their basic tasks of prediction and forecasting. Relatively few saw the coming disaster. It was not an accident that those who advocated the rules that led to the calamity were so blinded by their faith in free markets that they couldn’t see the problems it was creating. Economics had moved — more than economists would like to think — from being a scientific discipline into becoming free market capitalism’s biggest cheerleader. If the United States is going to succeed in reforming its economy, it may have to begin by reforming economics.”

Piketty (2014) also points toward the present state of crisis in economics and maintains:

“To put it bluntly, the discipline of economics has yet to get over its childish passion for mathematics and for purely theoretical and often highly ideological speculation, at the expense of historical research and collaboration with the other social sciences. Economists are all too often preoccupied with petty mathematical problems of interest only to themselves. This obsession with mathematics is an easy way of acquiring the appearance of scientificity without having to answer the far more complex questions posed by the world we live in.”

5. WHY WAS THERE NO PARADIGM SHIFT IN FAVOR OF ISLAMIC ECONOMICS?

At this juncture we come to the second part of the paper, that irrespective of the crisis in mainstream economics thinking, why did Islamic economics fail to make a long-lasting mark in academic circles? In other words why did Islamic economics fail to establish itself as an alternative paradigm in contrast to the mainstream neoliberal economic paradigm¹⁸, irrespective of galore failures of the later such as recurring global economic recessions, persistent global poverty, increasing inequalities between and within different economies, and so forth. The answer lies in the complex nature of neoliberalism and neo-liberal thought as well as the current state of Islamic economics.

First the neoliberal thought is very well grounded, which makes it structurally hard for alternative perspectives (including the Islamic one) to replace it. Mirowski (2013) argues that neoliberalism as an ideology has become bullet proof and neoliberal thought has become so pervasive that any countervailing evidence serves only to further convince disciples of its truth. He is of the view that neoliberalism tends to have, what he calls a ‘Russian Doll’ structure where in the most central ones are well hidden from public eyes. He uses an ironic expression, ‘The Neoliberal Thought Collective’ (Mirowski and Plehwe, 2009) for the hidden innermost entities that formulate the movement’s doctrine. According to Mirowski (2013), Mont Pelerin Society (discussed earlier) is a Neoliberal Thought Collective institution. The ideas of this hidden core are frequently propagated by venues and centers formally unconnected to the center such as academic economic departments, research institutes, and so forth. He is of the view that as neoliberal ideas trickle down from above they also well up from below, reinforced by social institutions

and daily patterns of life. This triumph of neoliberal thought is also partly attributed to loyal opposition from economists such as Krugman and Stiglitz. Even though Krugman and Stiglitz criticized the efficient market hypothesis, Mirowski argues that such an attempt while retaining the basic theoretical underpinnings of neoclassical thought rendered this criticism doubly ineffective.

Secondly the current state of Islamic economics is akin to what Kuhn would have termed as ‘pre-paradigm’¹⁹, it is yet to establish itself as a distinct paradigm. The advocates of Islamic economics have been unsuccessful in shaping a distinctive paradigm for their discipline. Islamic economics in its present state lacks a clear cut subject-matter, well-organized body of knowledge, methodology to appraise theories and systematic accumulation of knowledge (Furqani, 2015). Haneef (2016) and Khan (2015) are of the view that the Islamic economists never laid the methodological basis of the discipline because they mistook *uṣūl al-fiqh* for methodology. According to Mahomedy (2013) the epistemological roots of Islamic economics have remained firmly within the framework of rationalism/empiricism and methodological individualism. Therefore, “Islamic economics has not been able to shed its neoclassical moorings, the very paradigm it originally set out to replace.” In order to understand the current state of Islamic economics, let us take a retrospective look at the recent history of Islamic economic thought.

5.1 DISCIPLINARY EVOLUTION OF ISLAMIC ECONOMICS AND THE ARTIFICIALITY OF ISLAMIZATION PROJECT

The origins of Islamic economics, as an alternative paradigm of an economy based on freedom, enterprise and, ethics and compassion can be traced to the early 1930s and 1940s, when faced by worldwide economic crisis and communist ideological doctrine, many Muslim scholars attempted to delineate the economic perspective of Islam²⁰ (Sardar, 1989). This is sometimes referred to as the first wave of Islamic economics. Soon the Islamic world was re-emerging after centuries of colonization; there was a creation of independent Muslim states, which further provided the impetus to the emerging discipline. A strong religious obligation on Muslims to shun interest, to pay *zakāt* and so forth, created a lot of enthusiasm for Islamization of economics. By the 1970s when Muslim countries such as Pakistan, Iran, and Sudan underwent a political resurgence, not only did the rulers oblige the people with pro Islamic legislation, the evolving discipline got much required institutional funding and an institutional base. Soon

there was what is termed as the Second Wave of Islamic Economics, believed to have started with the First International Conference on Islamic Economics held in Makkah in 1976²¹. There was an emergence of academic journals on Islamic economics, mushrooming of departments of Islamic economics across many universities around the Muslim world, and the proliferation of Islamic banks. This all led to the production of immense literature on Islamic economics. Siddiqi (1981) in his study “Muslim Economic Thinking” mentioned some 700 references in English, Urdu and Arabic pertaining to the discipline; while Khan in his 1983 book ‘Islamic Economics’ mentions some 1300 references in English and Urdu. However, post 1980s the enthusiasm around Islamic economics started fading until it was the recession of 2007-2008 that brought the discipline back into the limelight²². Muqorobin (2008, see Mahyudi, 2016) reveals that the database of Islamic Economics in the International Islamic University Malaysia library alone functions as a depository of approximately 5000 publications on Islamic economics and finance from 1994 to 2005. According to the Harvard Islamic Finance databank more than 9000 records were available for free access in June, 2013 (Khan, 2013).

Mahomedy (2013) mentions three pathways along which Islamic economics has evolved. The central thrust of the first pathway was to denounce the inherent weaknesses of other economic ideologies such as capitalism, socialism and communism. Most of the scholars concerned with this pathway described Islamic economics negatively (i.e., in terms of what it is not), rather than developing any positive content for it. In contrast to the first pathway, the second pathway adopted a conciliatory approach toward the values and practices of other economic ideologies. Finally the third track along which Islamic economics evolved was the venture undertaken by its proponents to establish and anchor the discipline as a modern science. The literature in this category is much more detailed, technical and rigorous than in the other two categories. For Nasr (1989, see Mahomedy, 2013) this pathway represented an attempt by Islamic economists to engage neoclassical thought in a dialog and imbue into western materialism a sense of the sacred.

An important dimension in the overall disciplinary evolution of Islamic economics was the project of islamization of economics (that was part of a grand project of Islamization of knowledge) which largely tried to ascertain the relevance of Islam to the mainstream economic thought. Most of the research on Islamization of economics withheld the belief that economics as a discipline can be islamized

by getting away with the un-Islamic elements and by infusing the Islamic principles into mainstream economics. Thus recipe for the Islamization project was simple; infuse Islamic principles, no need to change the basic architecture of the mainstream economics. What emerged from these endeavors was a discipline Islamic in exterior, but neoclassical and capitalistic inside. The project of Islamization of knowledge failed to realize that every discipline emerges in a particular social and cultural context, has implicit worldviews, hegemonies and disciplinary powers associated with it²³. What was argued by Sardar in 1989 seems to be right even after a couple of decades:

“On the whole, Muslim economists took the western discipline with all its assumptions and underlying values, of which they are so critical, and tried to infuse Islamic notions and principles into it. Consequently, the charge against Islamic economics that it is little more than capitalist economic thought with an Islamic facade (‘capitalism minus interest’) has some justification.”

Similar assertions are made by Siddiqi (2015) about the programs offered by universities in Islamic economics:

“A mist of artificiality surrounds the programmes, not to mention the superficiality of its content. There is a perception, partly thanks to the ‘Islamisation of Knowledge’ project, that we can simply graft the new on to the old. That the old may need to be rethought, modified or trimmed does not occur to the legions of researchers working the field. Indeed, to question the old Islamic economic norms is almost regarded as blasphemous.” Siddiqi (2015)

Since most of the assumptions of mainstream economics were not challenged by the Islamization project, the neoclassical construct of *homo economicus* and the Islamic construct of *homo Islamicus*, in their *modus operandi* seemed to be blood relatives, if not identical twins. While the former evokes images of a selfish man with a “lightening calculator of pains and pleasures”²⁴, the later evokes images of an angelic being that uses ethical yardstick to arrive at every economic decision. Ironically we can find neither of the two in the real world²⁵.

5.2 THEORY AND PRAXIS DIVIDE IN ISLAMIC BANKING AND FINANCE INDUSTRY

Similarly, the discourse to islamicize the institutions followed the same course; to infuse Islamic notions and ideals into the institutions. For instance, the institution of modern banking, based on interest was to be islamicized by taking out interest and usury (*ribā*) and infusing the Islamic substitutes of *mushārah* (partnership contracts) and *muḍārah* (equity participation). Many theoretical models for interest free banking were proposed without challenging the basis of the institution of modern banking. Since there was no major structural change in the institution of banking as such, and the *modus operandi* was largely the same, the theory and practice divide was an expected consequence. The basic tenet of Islamic Finance i.e. justice (*‘adl*) took a back seat and the Islamic finance industry behaved more like a capitalistic industry. Siddiqi (2013), who was one of the pioneers of Interest free Banking, argues that by the 1980s itself the strains between aspirations and reality had occurred. He is of the view that:

“The well documented ills of conventional finance are accompanying *Shari‘ah*-compliant Islamic finance also. It is not inclusive, by passing the majority of Muslims in the areas it is operating, it helps moving wealth upwards towards top of the pyramid like its conventional counterpart and it is barely contributing to the economic development of the Muslim countries and communities.” (Siddiqi, 2013).

The reality of the latest avatar of Global Islamic Finance, the Islamic Financial Service Industry (IFSI) is that despite its celebrated growth over the past decade, crossing the USD 1.87 trillion mark in 2014, has neglected the poor and middle class. The corporate sector has literally become the major beneficiary of this development. Hence a relevant question many researchers are asking, is if the present Islamic banking system is Islamic at all. Or is it a neoliberal institute masquerading as an Islamic one. The revelations of Irfan (2014), the insider²⁶ of the Islamic finance industry, are very important. He tells many stories of the world of Islamic finance; how many ‘reverse engineered’ and dodgy products get approval from the *shari‘ah* boards and how *shari‘ah* compliance is compromised in an effort to keep up sophisticated tools of western investment banks. Thus it is evident that the simplistic assumption to Islamicize the neoliberal institutions by infusing Islamic ideals into them has been a failure²⁷. In fact these

failed attempts can dent the identity of Islam as an alternative, help assimilation of this alternative into mainstream capitalism, and also haunt future development of Islamic alternatives as well.

5.3 LIMITED DISCIPLINARY CONTOURS OF ISLAMIC ECONOMICS

Another important feature of this course of disciplinary evolution is that Islamic economics has left many areas of economy untouched. So far, the major part of literature on Islamic economics dealt with monetary and financial issues. There is also some literature (although scant) on Islamic jurisprudence, *zakāh* and taxation, ownership rights, inheritance laws and Islamic notions of development, co-operation between Islamic countries, and so forth. Many aspects of the current reincarnation of economy in the form of ‘knowledge economy’²⁸ have not been dealt with so far by the discipline of Islamic economics. There is no discussion whatsoever, leave aside theorization of many important and contemporary aspects of economy such as mode of production, innovation, technological diffusion, intellectual property rights, research and development etc. The disciplinary contours of Islamic economics are highly limited, dealing mostly with the financial aspects of economy.

5.4 LACK OF EMPIRICAL STUDIES

In addition to the little success in articulating a coherent theoretical paradigm for the discipline, the Islamic economists have failed to demonstrate how their ideas would find practical expression in the present global context. There is a dearth of literature on the empirical aspects of Islamic economics. According to Siddiqi (2008), “As things stand now, all new energy seems to be destined for destroying what is perceived to be un-Islamic, with no clear vision of what to replace it with.”

5.5 ORIENTATION OF ISLAMIC ECONOMICS TOWARDS THE PAST

The way Islamic economics has evolved has meant going back to Islamic rules on economy (*uṣūl al-iqtisād*), compiled largely during the golden age of Islam. The orientation of the discipline largely remained orientated toward the past rather than the future. This is the problem according to Ziauddin Sardar (1985, 1987) not only associated with Islamic economic thought, but with the overall contemporary Islamic thought. According to him Muslim societies are not always good at

looking toward the future; dwelling instead on the glories of the past and feeling fatalistic about the present²⁹. Much of the contemporary Islamic scholarship shies away from creative and innovative thinking. Centuries of rusting in the machinery of legal studies due to the non-involvement of the Islamic scholars in reinterpretation of Islamic principles according to contemporary reality has led to failure of *ijtihad* in general and Islamic economics in particular.

The web created by all these factors meant that Islamic economics could not emerge as a full-fledged discipline with clear cut subject-matter, well-organized body of knowledge, methodology to appraise theories and systematic accumulation of knowledge. This meant that even if there were overwhelming crisis in mainstream economics, Islamic economics could not establish itself as a strong alternative paradigm.

6. CONCLUDING REMARKS

The economic order of the world is in tatters, the neoliberal system is not working or just working for one percent of the world population who are accumulating the bulk of wealth at the expense of increasing inequality. Many renowned economists like Atkinson (2015), Bowles (2012), Piketty (2014), Stiglitz (2013), etc. have proved that increasing inequality is a distinguishing feature of recent economic growth at global level. According to Global wealth report 2016 (Credit-Suisse, 2016) the top 1 percent of adult wealth holders in the world own 51 percent of all global wealth, while the bottom half of adult own only 1%. According to report, the top 10 percent of adults own 89 percent of all the worlds' wealth. Consequently many parts of the world even now face abject poverty, malnutrition, hunger and deprivation. The system is characterized by high unemployment rates, increasing inequalities, recurrent bubbles and recessions, debt crisis and so forth. This system is flourishing under the shadow of mainstream economic thought. Consequently both neoliberalism and mainstream neoliberal economic thought are under attack from within and without academia. This is represented by the plethora of literature mentioned above and various mass movements against increasing social and economic inequalities such as Occupy Wall Street³⁰, etc.

Islamic economics as an alternative paradigm based on freedom, enterprise and ethics, and compassion has not been a successful endeavor as well; thanks to the artificial nature of the so called Islamization project which attempted to recast a new discipline on the basis of the old discipline and construct new institutions from

the old ones by just infusing Islamic notions into them. The Islamization of economics project failed to realize that every discipline emerges in a particular social and cultural context, has implicit world-views, hegemonies and disciplinary powers associated with it.

If Islamic economics is to truly emerge as an alternative paradigm that is just and ethical in contrast to the mainstream neoliberal world-view, it should shun all the baggage, constructs, and assumptions from the mainstream economics. Its proponents must resolve its theoretical and practical inconsistencies and articulate a coherent paradigm with a clear cut subject-matter, well-organized body of knowledge and methodology to appraise theories so that there can be a systematic accumulation of knowledge. Mahyudi (2016) has rightly argued that the future of Islamic economics as a discipline is at stake if its proponents continuously ignore Timur Kuran's (1995, see Mahyudi, 2016) valid criticism that Islamic economics presents no empirical support for its far-reaching theoretical claims. Islamic economics as an alternative paradigm should simultaneously focus on critique as well as construction. There is a need to re-imagine the assumptions of Islamic economics as a discipline, which are representative of Islamic principles as well the current economic reality. As a discipline Islamic economics can learn a lot from the present crisis of mainstream economics that is attributed to the dominance of positivist paradigm and arid mathematical formalism discussed before.

Islamic economics can take a meta-disciplinary, inter-disciplinary or multi-disciplinary outlook, move beyond the positivistic approach of mainstream economics and bring back history, sociology and philosophy into its paradigm. There is also a need for Islamic economics to walk into the so-far untrodden roads of knowledge economy and embrace different areas of economy such as modes of production, innovations, R&D, intellectual property rights, issues of inequality, poverty, gender and so forth into its ambit. This re-imagination of Islamic economics should also be accompanied by the re-imagination of new institutions grounded in the reality of Islamic economy and society³¹. There is a lot of literature stressing the need to develop Islamic institutions within the perspective of *maqāṣid al-sharī'ah* (purposes of *sharī'ah*). However it needs to be stressed that the idea of *maqāṣid al-sharī'ah* is not an impervious idea of the Islamic past³² but an idea that can be reinvigorated according to present reality and future prospects of the Muslim world.

ENDNOTES

1. Chapter 24 of General Theory of Employment, Interest and Money.
2. However, this notion may be challenged, where in the positivism itself can be seen as been influenced by ideology. See Backhouse (2010).
3. This statement is also attributed to U.S. President Richard Nixon.
4. Similar views were propounded by E.S. Phelps in an article 'Phillips Curve: Expectations of Inflation and Optimal Unemployment over Time' (1967). Invoking the concept of inflationary expectations both Phelps and Friedman challenged the existence of Phillips curve in the long run that is in the long run there is no decreasing function between unemployment and the growth rates of money wages (Screpanti and Zamagni, 2005).
5. A myth also developed that Keynesian economists had failed to anticipate that any attempt to create full employment would lead to stagflation. In reality, the Council of Economic Advisers (CEA), comprising economists with impeccable Keynesian credentials, had warned of the danger (see Backhouse, 2010; and Backhouse and Bateman, 2011).
6. This hypothesis did not fit the data as well.
7. The views of the RBC theorists and new classical theorists finally merged into what is known as DSGE (The Dynamic Stochastic General Equilibrium Model) and is the main workhorse of macroeconomic theorizing.
8. Their effort to resurrect Keynesian economics on the underpinnings of wage stickiness is no small irony, given that Keynes's writings were largely meant to find a way to move beyond theories of wage stickiness as an explanation of mass unemployment.
9. Similar views were put forward by many economists such as Joseph Stiglitz, Robert Skidelsky etc. In fact, a well-known post Keynesian economist, Robert Skidelsky, wrote a book on the recession in 2009, 'Keynes: The Return of the Master'.
10. There were attempts before this; like Walter Lippmann Colloquium-a conference organised in Paris in 1938, establishment of America Enterprise Institute (AEI) in 1943 and Foundation for Economic

Education (FEE) in 1946, but they were not as successful as the MPS.

11. See Plehwe and Walpen (2006), and Backhouse (2010).
12. Formerly Atlas Economic Research Foundation; a non-profit organization that brings freedom to the world by helping develop and strengthen a network of market oriented think tanks that spans the globe. At the 30th anniversary of the IEA, Fisher referred to 'a family of 40 institutes in 20 countries' (Frost 2002). By the end of the century there were 150 such bodies.
13. Hybrid of a machine and organism, Merriam-Webster dictionary defines *cyborg* as human having normal biologic capability enhanced by or as if by electronic or electromechanical devices.
14. He argues that econometrics, game theory, Keynesianism of the post-war era, financial economics, evolutionary economics, etc., shared close ties with computer sciences.
15. Discussed in earlier section.
16. This section is largely based on Gattoo and Gattoo (2013).
17. Although it should be noted that criticism of the economic discipline as such was also happening during same period from heterodox schools. For intake see 'Economics Confronts the Economy' (2006) by Philip Klein, 'A Guide to Whats Wrong with Economics' (Fullbrook 2004) in which no lesser than 27 authors wrote different and allegedly fundamental flaws in the subject and Stevin Marglin's 'Dismal Science: How Thinking Like an Economist Undermines the Community' (2010), the message of which is clear from the titles of these books.
18. Kuhn (1996) in his monumental work, 'The Structure of Scientific Revolutions', propounded a view of paradigm shift within the sciences. Roughly speaking, a paradigm shift in a discipline takes place when a revolution changes the matrix of the discipline so as to permit solution of more serious puzzles, which are not solved within the boundaries of the earlier disciplinary paradigm.
19. It needs to be noted that for Kuhn, all social sciences were pre-paradigms because for him a clear cut consensus in social sciences was impossible. Therefore in social sciences paradigm shifts are rarest yet strong paradigms can simultaneously exist. Here by pre-

paradigm we want to stress the early stages of development of Islamic economics as a discipline.

20. See the works of Maududi (1941/1992), Qutb (1948/2000), Sindhi (1944/n.d.), etc.
21. The papers presented during the conference confirm to the thesis that second wave of Islamic economics concerned with details, technical and operational aspects as opposed to general outlook of the first wave (Zaman, 2008).
22. We have only produced brief account of disciplinary evolution of Islamic economic. For a full account please refer to El-Ashker and Wilson (2006) and Haneef (2016) which touches on literature regarding the Islamic economic methodology.
23. See Sardar (2013); and Becher and Trowler (2001).
24. See Veblen (1898).
25. For the discussion regarding the absence of homo-islamicus in the real world, see Mahyudi (2016).
26. Worked as an investor banker in the Middle East and Europe, headed Islamic Finance at Barclays and founded Cordoba Capital, an Islamic finance advisory firm.
27. Although Irfan (2014) is quite optimistic to conclude that for all Islamic finance's shortcomings, its introspection is source of strength and so long it can assert its social mission, it can bring something of benefit to Islamic as well as western world.
28. Since the last decades of the 20th century there have been the spawning of the terms woven around the term 'knowledge' like knowledge economy, knowledge society, knowledge management, knowledge worker so on and so forth. The prima facie rationale for this is the increased importance of knowledge and its applications as an important factor to determine the growth and prosperity of a society/economy in the recent years. It is argued that in contrast to agrarian and industrial mode of development, the informational mode of development is characterised by the action of knowledge upon knowledge itself, as the main source of productivity (Castells, 1996).
29. Siddiqi (2008) rightly cautions us about the tendency of sacralization of the non-sacred Islamic history.

30. Occupy Wall Street (OWS) was a public protest movement that began on 17 September, 2011, in Zuccotti Park, located in New York City's Wall Street Financial District, attracting a global attention and spawning worldwide movement against social and economic inequality and undue influence of corporations on government. The main slogans of OWS movement "We the 99 Percent" and "1 percent versus 99 Percent" highlighted the question of an unequal economic order.
31. Zaman (2015) argues that *waqf* is the alternative to banking institutions and need to be given primacy. However he is completely silent about its working in the present global settings.
32. Propounded by great figures such as Al-Ghazālī (1406/1986), and Al-Shāṭibī (n.d).

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