



THE FOUNDATIONS OF ISLAMIC ECONOMICS:
A PHILOSOPHICAL EXPLORATION OF THE
DISCIPLINE

BY

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ABSTRACT

The study explores aspects of the philosophical foundations of Islamic economics to determine if it qualifies to be called a scientific discipline. To qualify, it has to have a clear subject matter, a well-defined body of knowledge, methodology or methodologies to appraise theories and progress in its development. In almost four decades of its development, the study argues that the discourse on these foundations has been relatively limited and this has stunted its genuine and sustainable progress. Qualitative library research with discourse analysis representing the discursive tradition in Islamic scholarship is employed in this study. By observing the present state of affairs in the literature of Islamic economics and utilizing works on philosophy of science in both Islamic and Western traditions, the study attempts to develop the foundational core of Islamic economics as a scientific discipline that will serve as a platform from which further development can take place. The research first discusses the concept of worldview that acts as the unseen foundation of all bodies of knowledge and action; hence it has clear implications for the development of the discipline. The study approaches the subject matter under the specific branches of philosophy- the ontological, epistemological and axiological dimensions- to provide a more systematic reflection of those foundations of Islamic economics. Two chapters each discuss the three dimensions: one generally critically surveys the literature, while the second provides inputs for the 'Islamic perspective' in those dimensions. The ontological dimension of Islamic economics investigates the nature and fundamental elements of Islamic economics, including its definition, subject matter, nature and scope. The epistemological dimension analyses how the various sources of knowledge in Islam impact the methodology of Islamic economics and affects the criteria, principles and purpose of theory appraisal and evaluation. The axiological dimension examines the concept of values in an Islamic economic system and how these values can be incorporated in both theory and policy prescriptions. The study concludes that genuine Islamic economics must proceed from a sound foundation/philosophy of Islamic economics and that more serious research should be undertaken in this area of research.

خلاصة البحث

الدراسة تستكشف جوانب الأسس الفلسفية للاقتصاد الإسلامي لتحديد ما إذا كانت مؤهلة للتصنيف كنظام علمي. لتكون كذلك، يجب أن تتوفر على موضوع واضح، هيئة معرفة محددة بشكل جيد، و منهجية أو منهجيات لتقييم النظريات و التقدم في تطورها. في ما يقارب أربعة عقود من التنمية، الدراسة تبرهن على أن الحديث عن هذه الأسس كان محدودا نسبيا، وهذا ما أعاق تقدمها الحقيقي و المستدام. في هذا البحث استخدمت المنهجية النوعية المكتبية مع تحليل الخطاب الذي يمثل التقليد الاستطراذي في الفقه الإسلامي. من خلال مراقبة الوضع الراهن في أدبيات الاقتصاد الإسلامي و الاستفادة من فلسفة العلم في التقاليد الإسلامية والغربية على حد سواء، تحاول الدراسة تطوير الأسس الرئيسية للاقتصاد الإسلامي كنظام علمي يكون بمثابة المنصة التي يمكن من خلالها القيام بمزيد من التطوير. وبالإضافة إلى ذلك، سيتم تحليل مقارن لجوانب مختارة من فلسفة الاقتصاد التقليدي وكذلك بعض المناقشات التي تجري داخل الاقتصاد كتحديد وتحليلها. الدراسة تتناول الموضوع تحت فروع محددة للفلسفة، خاصة البعد الوجودي، المعرفي و القيمي، لتوفير مزيد من التفكير المنهجي لأسس الاقتصاد الإسلامي. في البداية يناقش البحث مفهوم النظرة التي تعتبر بمثابة الأساس الغير المرئي لجميع هيئات المعرفة والعمل، وبالتالي فإن له آثار واضحة في تطوير هذا النظام. في فصلين تتم مناقشة الأبعاد الثلاثة : الأول يتدارس الأدبيات عموما وبشكل نقدي، في حين أن الثاني يوفر مساهمات لـ"المنظور الإسلامي" في تلك الأبعاد. البعد الأنطولوجي للاقتصاد الإسلامي يحقق في طبيعة الاقتصاد الإسلامي وعناصره الأساسية ، بما في ذلك تعريفه ، موضوعه ، طبيعته ونطاقه. في البعد المعرفي الدراسة تحلل تأثير مختلف مصادر المعرفة في الإسلام وتصميم موضوع الدراسة على منهجية الاقتصاد الإسلامي. وسوف يؤثر هذا على المعايير، المبادئ، وكذا الغرض من التقييم النظري. في البعد القيمي، الدراسة تبحث في مفهوم القيم في نظام الاقتصاد الإسلامي، وكيف يمكن دمج هذه القيم في النظريات الاقتصادية الإسلامية، وكذلك في توصيات السياسة. سوف تفسر الأسس الدقيقة للنظام كعرض حالة من استيعاب الأخلاق الإسلامية. خلصت الدراسة إلى أن الاقتصاد الإسلامي الحقيقي يجب أن ينطلق من أساس سليم للاقتصاد الإسلامي، وأنه ينبغي إجراء بحوث أكثر جدية في هذا المجال.

APPROVAL PAGE

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Hafas Furqani

Signature

Date

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

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CHAPTER 1

INTRODUCTION

1.1. BACKGROUND OF THE STUDY

Although the discourses on ‘economic’ ideas in Islam can be traced back to the writings of scholars in early Islamic intellectual tradition, the idea to give it a ‘discipline focus’ is a twentieth century phenomena (Siddiqi, 1988: 1). The 1970’s and 1980’s saw a movement to explicate what was claimed to be a more formal and organized body of knowledge - a discipline - called ‘Islamic economics’. There was a call in contemporary time to reconstruct Islam’s scholarly legacy and in our case, to construct an economics discipline utilizing and manifesting an Islamic epistemological framework. In the practical realm, there was consciousness to rearrange everyday socio-economic aspects of life in line with Islam’s injunctions and within the overall framework and system of Islam, to provide indigenous solutions to the problems of the *ummah*.

The effort to establish contemporary Islamic economics, is done through interaction and integration of Islamic intellectual legacy and modern knowledge. There is wide consensus that contemporary social science (including economics) can be Islamized by integrating/reviving/modernizing ‘past’ concepts/practices/institutions with the existing concepts/practices/institutions or by developing ‘new’ concepts/practices/institutions to address Muslims’ needs, particularly in their economic life.

Scholars have systematically attempted to discuss various aspects of an Islamic economics discipline. Islamic economics has also been systematically discussed over

the last three decades as a new (prospective) discipline and has also been included in the curricula of universities in various Muslim countries. We have seen attempts at developing models, theories and methodological instruments offered by Islamic economists as ‘alternatives’ to modern economic theories. Their credibility as well efficacy, however, is questioned. Gaps pertaining to the discipline foundations i.e. in the subject-matter, body of knowledge, methodology/methodologies to appraise and justify theories in an Islamic framework are yet to be elegantly addressed.

This thesis tried to help address this gap in correspondence to the various upheavals -referred to by some as ‘crises’ in modern economics science- as well as the insufficient response and gaps in the Islamic economics research program that (1) seems to have moved into downstream issues of Islamic banking and finance while seemingly sacrificing the foundational framework of an Islamic economics discipline; and (2) has misrepresented the Islamization of knowledge (IOK) program by working on downstream areas, at the expense of the genuine foundational agenda of the IOK agenda. The IOK agenda applied to economics seems to have taken the existing conventional economics’ foundations and body of knowledge as is, or with minimal modification rather than what genuine Islamization of knowledge requires.

1.2. RATIONALE OF THE STUDY

The study is founded on three premises. *First*, the mainstream economic crisis. The mainstream body of knowledge of economics based on the neoclassical school is increasingly criticized for its shortcomings and lack of coherence in “understanding” of real economic problems; lacks “appropriate methodology” to deal with problems and hence “solutions” provided are not comprehensive. There is a common call for developing new perspective/s in understanding economic phenomena, new

approach/es in solving economic problems and realizing human wellbeing as well as proposing new goals of economics to be achieved. *Second*, there is an insufficient response- and hence gaps- in Islamic economics research. Islamic economics as a discipline is still at a formative stage. Nevertheless, the discourse of an Islamic economic philosophy - that discusses the foundations of Islamic economics if it is to be a discipline – is limited and rather ‘elementary’ as the scientific community moved its attention into downstream areas of banking and finance. *Third*, there is a need for a serious work in the area of philosophy of Islamic economics that can establish these foundations of Islamic economics as reflected in the body of knowledge, subject-matter, and methodology to appraise theories to ensure progress in knowledge accumulation. Developing an Islamic body of knowledge of economics, and/or Islamizing modern economics, cannot be done properly without a clear and coherent philosophical foundation that is projected from an Islamic worldview or vision. Only then can the discipline sustain itself or to provide ‘genuine Islamic alternatives’ to contemporary mainstream economics with the indigenous solutions requested.

1.2.1. Mainstream Economics Crises

The emergence of Islamic economics as a system of thought and practice is timely. The mainstream body of knowledge of economics based on the neoclassical school is increasingly criticized by the intellectual community for its shortcomings and lack of coherence in its understanding of real economic problems as well as its lack of appropriate methodology to deal with those problems.

This thesis argues that the root of the problems lie in the discipline foundations that include the ontological, epistemological and axiological dimensions. Mainstream neoclassical economics is criticized for putting the discipline in an imaginary world,

cut off from reality (Coleman, 2002: 3). It is built on foundations abstracted from phenomena in a simplified and reductionist way. The economic man for example is conceived as having ‘semi-human’ behavioral characteristics of a self-interested maximizer. Social-interest which is a valid dimension of being ‘human’ is either subsumed in discussion of self-interest or considered as an exogenous variable and ignored.

Likewise, the free market mechanism is conceived based on the assumptions of self-regulation and self-correcting, producing a unique and stable equilibrium, which is never taking place as propagated. Any intervention and constraint is considered sacrosanct as it would distort the market mechanism. Free markets are often mistaken for and equated with, unregulated markets. With unconstrained behavior, markets are ‘jungles’ that are dominated by the powerful, since perfect competition has never truly existed and asymmetric information has always prevailed (in addition to high risk, volatility and conflict of interests). It is evident, markets that are let free and unregulated create greater problems (Stiglitz, 2010: xxii). Ethics are also excluded in the subject-matter of economics as scientification is confined to the positive and empirical meaning. Normative analysis is shunned from the formal body of economics. This has adversely affected the discipline, made it an ‘impoverished science’ that has been unable to capture the all dimensions of reality and the complex aspects of economic behavior (Sen, 1990: 7).¹

In the epistemological dimension, the methodology developed is not adequate to explicate real economic phenomena or capture the complex nature of life as its subject-matter is treated in an oversimplified manner and as a closed system. The

¹ Broome (2004: 2) observes ethics is taken out from economics because “economics has developed sophisticated formal theories that are intended to analyse structure of people’s preferences. It happens that these theories can be turned to analyzing the structure of good.”

triumph of mathematization and empiricism of economics has been blamed as the key impetus behind the narrowing of mainstream economics that rejects all matters that cannot be put into mathematical equations or that cannot be quantified empirically (Hodgson, 2003: 144).

The dynamism of complex ontological, social and empirical reality is not well captured in the methodology to build models and appraise theory. This is because, economic methodology as Fulbrook (2009: 4) describes “instead of being led by ontological enquiry, one defines a priori, the ontology to fit the method - and hence - becomes disconnected with real economic problems.” As a result economic theories and models are unfit to accommodate the multi-dimensions of individual motives and wellbeing and treat them as exogenous, if not described in a rudimentary way (Spaventa, 2009: 136). Nevertheless, theory construction has continued this way. As a rule, mainstream economists are reluctant to envisage different models and different tools in economic analysis.

In the practical realm, recent financial crisis invite further criticism of the weaknesses in mainstream neoclassical economics. Economists do not only fail to foresee the crisis, they are also blamed for creating the crisis by allowing robust financial engineering techniques to create sophisticated but fragile instruments (or derivatives), for leveraging credit and managing risk- all in the name of increasing potential profit (Kirman, 2009: 80). The recent 2008 financial and economic crisis is not the outcome of some sudden and unexpected shock, but has been an ‘accumulating crisis’ since the great depression of 1929. Krugman (2009) admits that few economists saw the current crisis coming due to the profession’s blindness to the very possibility of catastrophic failures in a market economy due to certain ideological positions.

In fact, the crisis, Soros (2008: 312) concludes “was generated by the financial system itself” and “contradicts the prevailing theory, which holds that financial markets tend toward equilibrium and that deviation from the equilibrium either occur in a random manner or are caused by some sudden external events to which markets have difficulty adjusting”. The theory has been used to justify the belief that the pursuit of self-interest (consistently equated with selfishness), should be given free rein and markets should be deregulated. In reality, these events should ‘prove’ that the market system is unable to suitably discipline powerful human motivations (greed), hence equally depends on institutions that constrain and limit its counter-productive effects.²

With the shortcomings in the conceptual and practical dimensions of mainstream economics, there is an increasing awareness that there is something wrong with the discipline foundations themselves as well as the doctrine on which mainstream theories are based. This, according to Heukelom and Sent (2010) is essentially a crisis of mainstream neoclassical economics that should provide impetus for new research programs. Radical changes need to be instituted to prevent and anticipate - if not avoid totally - the everlasting multidimensional systemic crisis in human history.³ It is in this search for alternatives that we situate Islamic Economics.

1.2.2. Insufficient Response and Gaps in Islamic Economics Research

² Alan Greenspan (2008), the former Chairman of the US Federal Reserve Board, noted this in retrospect that “I made a mistake in presuming that the self-interests of organizations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in the firms”.

³ The latest movement in challenging the mainstream neoclassical economics is the post-autistic movement that began in France. In June 2000 a group of economics students published a petition on the web protesting against: (1) the lack of realism in economics teaching; (2) economics’ “uncontrolled use” and treatment of mathematics as “an end in itself,” with the result that economics has become an “autistic science,” lost in “imaginary worlds”; (3) the repressive domination of neoclassical theory and approaches derivative from it in the university economics curriculum; and (4) the dogmatic teaching style in economics, which leaves no place for critical and reflective thought. They argued in favor of (1) engagement with empirical and concrete economic realities; (2) prioritizing science over scientism; (3) a pluralism of approaches adapted to the complexity of economic objects and (4) to the uncertainty surrounding most of the big economic questions; and (5) their professors initiating reforms to rescue economics from its autistic and socially irresponsible state (Fullbrook, 2003: 1).

The current state of flux in mainstream economics should be kept in mind in efforts to develop Islamic economics. There is great hope in the Muslim world that Islamic economics will deliver the solutions to the problems faced both in the Muslim world and beyond. As a discipline, this translates as an approach to economic problems from an alternative perspective. However, unlike 1000 years ago, Islamic economics is faced with a dominant school of economics that has an established 'tradition', backed by political and social systems, set in a global, dynamic framework, representing modern western civilization.

The task seems to be at times monumental, requiring intensive intellectual effort from Islamic economists and scholars. The development of Islamic economics as a formal discipline is relatively young, roughly about four decades, compared to modern economics that has a 200 year head-start. While achievements can be seen in the last four decades, the future is not a guaranteed outcome. The spirit and foundations that tried to build Islamic economics from its sources of knowledge, visible in the early contemporary discussions of the 1970s may have fizzled out, giving way to the narrow focus of Islamic banking and finance for the last 2 decades or so.

Scholars, in the early three decades (1960's – 1980's) raised various fundamental issues in economics from a systemic perspective. Islamic economics was presented as part of an Islamic economic system, and contrasted to Capitalism and Socialism. The Islamic economic system was seen as part of a larger socio-economic and political order that had ideological implications. There were also attempts at developing a 'normal body of knowledge', a 'science' contrasted to mainstream economics. The discussion, while quite elementary, captured a wide range of issues

from system characteristics to issues and concepts in production, consumption, distribution and exchange; micro and macro aspects of behavior of the economic agent called ‘Islamic man’; policy areas including fiscal and monetary policy in an Islamic framework as well as Islamic economic institutions such as *waqf*, *zakāt*, *bayt al-māl*, banking and finance. Islamic economics seemed to have a ‘perspective’ (if not ‘alternative’) to many aspects of economics.

However, rather than allowing the natural development of the discipline to take its course, there seems to have been a ‘hijacking’ of sorts since the mid-1990s. Rather than exerting the intellectual efforts at strengthening the upstream areas of the discipline, we see the focus shifted into ‘downstream’ areas of Islamic banking and finance (IBF). While serving a real issue of providing interest (defined as being part of *ribā*) free finance, the failure to develop an Islamic economics foundation, from which finance proceeds naturally, has led to many accusations (some rather unfair) that much of Islamic banking and finance is merely ‘patchwork’, replicating mainstream finance. Very few have tried to develop and elaborate on a philosophy and methodology that is consistent with the Islamic worldview, and more specifically its economic vision.

While current practice and public policy debates need to be given attention, as far as Islamic economics is concerned, the discourse of an Islamic economic philosophy - that discusses the foundations of Islamic economics as a system and discipline - is relatively limited. With the neglect of the foundations of Islamic economics, those ‘downstream’ areas of Islamic banking and finance have therefore lost part of the bigger picture of the Islamic economic system. The neglect of this fundamental area has created a large Islamic banking and finance literature, but one that seems to lack conceptual or theoretical unity and coherence.

The current form of Islamic finance is claimed to be simply duplicating the structure of existing products in the market with the aim to make them *sharī'ah* compliant (i.e., legally in line with the Islamic law). This is based on the view that Islamic finance fundamentally shares the same profile and objective as its mainstream conventional counterpart (of maximizing profit) and only differs in form and structure. Unfortunately, this concern on legal compliance in the form and structure is done at the expense of asking more fundamental questions concerning the purpose of finance, the place of finance in real economic activities and the bigger aims it should seek to fulfill. Hence, present IBF is still unable to release itself from the dominant framework of debt based finance. While valid, alternatives are also needed lest we end up inheriting similar tribulations as the conventional system (Haneef, 2008: 164).

For this reason, many question the viability and contribution of IBF to helping address the major ailments of the *ummah* and also the sustainability of Islamic economics as a scientific discipline. Islamic economics, especially its foundations, has not received serious attention by scholars. The challenge to provide an alternative and coherent framework to the current economic knowledge is still left unanswered. Many new issues such as the stakeholder model, corporate social responsibility, sustainable business paradigms, the wider motives of individuals other than narrow self-interest, a broader understanding of wellbeing etc, are not well recognized in mainstream textbooks. To make matters worse, there is little awareness among Islamic economists of the shortcomings of the existing mainstream paradigm that has been widely criticized, even among Western scholars themselves.

This tells us that while reality (practice) is changing; it seems that mainstream economics is out of touch with reality. Therefore, Islamic economics should not