ISLAMIC ECONOMICS: WHAT IT IS AND HOW IT DEVELOPED

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Islamic economics has been having a revival over the last few decades. However, it is still in a preliminary stage of development. In contrast with this, conventional economics has become a well-developed and sophisticated discipline after going through a long and rigorous process of development over more than a century. This raises a number of questions, some of which are: Is it necessary to have a new discipline in economics? If so, what is Islamic economics, how does it differ from conventional economics needed, and has it made any worthwhile contributions over the centuries? This paper tries to briefly answer these questions in three parts.

I

IS A NEW DISCIPLINE IN ECONOMICS NEEDED?

It is universally recognized that resources are scarce compared with the claims on them. However, it is also simultaneously recognized by practically all civilizations that the well-being of all human beings needs to be ensured. Given the scarcity of resources, the well-being of all may remain an unrealized dream if the scarce resources are not utilized efficiently and equitably. For this purpose, every society needs to develop an effective strategy, which is consciously or unconsciously conditioned by its worldview. If the worldview is flawed, the strategy may not be able to help the society actualize the well-being of all. The prevailing worldviews may be classified for the sake of ease into two broad theoretical constructs (1) secular and materialist, and (2) spiritual and humanitarian.

The Role of the Worldview

The secular and materialist worldviews attach maximum importance to the material aspect of human well-being and tend generally to ignore the importance of the spiritual aspect. They often argue that maximum material well-being can be best realized if individuals are given unhindered freedom to pursue their self-interest and to maximize their want satisfaction in keeping with their own tastes and preferences.1 In their extreme form they do not recognize any role for Divine guidance in human life and place full trust in the ability of human beings to chalk out a proper strategy

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1 This is the liberal version of the secular and materialist worldviews. There is also the totalitarian version which does not have faith in the individuals’ ability to manage private property in a way that would ensure social well-being. Hence its prescription is to curb individual freedom and to transfer all means of production and decision making to a totalitarian state. Since this form of the secular and materialist worldview failed to realize human well-being and has been overthrown practically everywhere, it is not discussed in this paper.
with the help of their reason. In such a worldview there is little role for values or
government intervention in the efficient and equitable allocation and distribution of
resources. When asked about how social interest would be served when everyone has
unlimited freedom to pursue his/her self-interest, the reply is that market forces will
themselves ensure this because competition will keep self-interest under check.

In contrast with this, religious worldviews give attention to both the material
as well as the spiritual aspects of human well-being. They do not necessarily reject the
role of reason in human development. They, however, recognize the limitations of
reason and wish to complement it by revelation. They do not also reject the need for
individual freedom or the role that the serving of self-interest can play in human
development. They, however, emphasize that both freedom and the pursuit of self-
interest need to be toned down by moral values and good governance to ensure that
everyone’s well-being is realized and that social harmony and family integrity are not
hurt in the process of everyone serving his/her self-interest.

Material and Spiritual Needs

Even though none of the major worldviews prevailing around the world is
totally materialist and hedonist, there are, nevertheless, significant differences among
them in terms of the emphasis they place on material or spiritual goals and the role of
moral values and government intervention in ordering human affairs. While material
goals concentrate primarily on goods and services that contribute to physical comfort
and well-being, spiritual goals include nearness to God, peace of mind, inner
happiness, honesty, justice, mutual care and cooperation, family and social harmony,
and the absence of crime and anomie. These may not be quantifiable, but are,
nevertheless, crucial for realizing human well-being. Resources being limited,
excessive emphasis on the material ingredients of well-being may lead to a neglect of
spiritual ingredients. The greater the difference in emphasis, the greater may be the
difference in the economic disciplines of these societies. Feyerabend (1993) has
frankly recognized this in the introduction to the Chinese edition of his thought-
provoking book, Against Method, by stating that “First world science is only one
science among many; by claiming to be more it ceases to be an instrument of
research and turns into a (political) pressure group” (p.3, parentheses are in the
original).
The Enlightenment Worldview and Conventional Economics

There is a great deal that is common between the worldviews of most major religions, particularly those of Judaism, Christianity and Islam. This is because, according to Islam, there is a continuity and similarity in the value systems of all Revealed religions to the extent to which the Message has not been lost or distorted over the ages. The Qur’an clearly states that: “Nothing has been said to you [Muhammad] that was not said to the Messengers before you” (Al-Qur’an, 41:43). If conventional economics had continued to develop in the image of the Judo-Christian worldview, as it did before the Enlightenment Movement of the seventeenth and eighteenth centuries, there may not have been any significant difference between conventional and Islamic economics. However, after the Enlightenment Movement, all intellectual disciplines in Europe became influenced by its secular, value-neutral, materialist and social-Darwinist worldview, even though this did not succeed fully. All economists did not necessarily become materialist or social-Darwinist in their individual lives and many of them continued to be attached to their religious worldviews. Koopmans (1969) has rightly observed that “scratch an economist and you will find a moralist underneath.” Therefore, while theoretically conventional economics adopted the secular and value-neutral orientation of the Enlightenment worldview and failed to recognize the role of value judgments and good governance in the efficient and equitable allocation and distribution of resources, in practice this did not take place fully. The pre-Enlightenment tradition never disappeared completely (See Baeck, 1994, p.11)

There is no doubt that, in spite of its secular and materialist worldview, the market system led to a long period of prosperity in the Western market-oriented economies. However, this unprecedented prosperity did not lead to the elimination of poverty or the fulfillment of everyone’s needs in conformity with the Judo-Christian value system even in the wealthiest countries. Inequalities of income and wealth have continued to persist and there has also been a substantial degree of economic instability and unemployment which have added to the miseries of the poor. This indicates that both efficiency and equity have remained elusive in spite of rapid development and phenomenal rise in wealth.
Consequently there has been persistent criticism of economics by a number of well-meaning scholars, including Thomas Carlyle (*Past and Present*, 1843), John Ruskin (*Unto this Last*, 1862) and Charles Dickens (*Hard Times*, 1854-55) in England, and Henry George (*Progress and Poverty*, 1879) in America. They ridiculed the dominant doctrine of *laissez-faire* with its emphasis on self-interest. Thomas Carlyle called economics a "dismal science" and rejected the idea that free and uncontrolled private interests will work in harmony and further the public welfare. (See Jay and Jay, 1986). Henry George condemned the resulting contrast between wealth and poverty and wrote: “So long as all the increased wealth which modern progress brings goes but to build great fortunes, to increase luxury and make sharper the contrast between the House of Have and the House of Want, progress is not real and cannot be permanent” (1955, p. 10).

In addition to failing to fulfill the basic needs of a large number of people and increasing inequalities of income and wealth, modern economic development has been associated with the disintegration of the family and rise in the disintegration of the family, crime and anomie, and a decline in peace of mind failure to bring peace of mind and inner happiness. (Easterlin 2001, 1995 and 1974; Oswald, 1997; Blanchflower and Oswald, 2000; Diener and Oshi, 2000; and Kenny, 1999). One to these problems and others the *laissez faire* approach lost ground, particularly after the Great Depression of the 1930s as a result of the Keynesian revolution and the socialist onslaught. However, most scholars have concluded that government intervention alone cannot by itself remove all socio-economic ills. It is also necessary to motivate individuals to do what is right and abstain from doing what is wrong. This is where the moral uplift of society can be helpful. Without it, more and more difficult and costly regulations are needed. Nobel Laureate, Amartya Sen has, therefore, rightly argued that “the distancing of economics from ethics has impoverished welfare economics and also weakened the basis of a good deal of descriptive and predictive economics” and that economics “can be made more productive by paying greater and more explicit attention to ethical considerations that shaped human behaviour and judgment” (1987, pp. 78 and 79). Hausman and McPherson also conclude in their survey article in the *Journal of Economic Literature* on “Economics and Contemporary Moral Philosophy” that “An economy that is engaged actively and self-critically with the moral aspects of its subject matter cannot help but be more interesting, more illuminating and, ultimately, more useful than the one that tries not to be” (1993, p. 723).
WHAT IS ISLAMIC ECONOMICS AND HOW IT DIFFERS FROM CONVENTIONAL ECONOMICS?

While conventional economics is now in the process of returning to its pre-Enlightenment roots, Islamic economics never got entangled in a secular and materialist worldview. It is based on a religious worldview which strikes at the roots of secularism and value neutrality. To ensure the true well-being of all individuals, irrespective of their sex, age, race, religion or wealth, Islamic economics does not seek to abolish private property, as was done by Communism, nor does it prevent individuals from serving their self-interest. It recognizes the role of the market in the efficient allocation of resources, but does not find competition to be sufficient to safeguard social interest. It tries to promote human brotherhood, socio-economic justice and the well-being of all through an integrated role of moral values, market mechanism, families, society, and ‘good governance’. This is because of the great emphasis in Islam on human brotherhood and socio-economic justice.

The Integrated Role of the Market, Families, Society, and Government

The market is not the only institution where people interact in human society. They also interact in the family, the society and the government and their interaction in all these institutions is closely interrelated. There is no doubt that the serving of self-interest does help raise efficiency in the market place. However, if self-interest is overemphasized and there are no moral restraints on individual behaviour, other institutions may not work effectively - families may disintegrate, the society may be uncaring, and the government may be corrupt, partisan, and self-centered. Mutual sacrifice is necessary for keeping the families glued together. Since the human being is the most important input of not only the market, but also of the family, the society and the government, and the family is the source of this input, nothing may work if the families disintegrate and are unable to provide loving care to children. This is likely to happen if both the husband and wife try to serve just their own self-interest and are not attuned to the making of sacrifices that the proper care and upbringing of children demands. Lack of willingness to make such sacrifice can lead to a decline in the quality of the human input of all other institutions, including the market, the society and the government. It may also lead to a fall in fertility rates below the
replacement level, making it difficult for the society not only to sustain its development but also its social security system.

**The Role of Moral Values**

While conventional economics generally considers the behaviour and tastes and preferences of individuals as given, Islamic economics does not do so. It places great emphasis on individual and social reform through moral uplift. This is the purpose for which all God’s messengers, including Abraham, Moses, Jesus, and Muhammad, came to this world. Moral uplift aims at the change in human behaviour, tastes and preferences and, thereby, it complements the price mechanism in promoting general well-being. Before even entering the market place and being exposed to the price filter, the consumers are expected to pass their claims through the moral filter. This will help filter out conspicuous consumption and all wasteful and unnecessary claims on resources. The price mechanism can then take over and reduce the claims on resources even further to lead to the market equilibrium. The two filters can together make it possible to have optimum economy in the use of resources, which is necessary to satisfy the material as well as spiritual needs of all human beings, to reduce the concentration of wealth in a few hands, and to raise savings, which are needed to promote greater investment and employment. Without complementing the market system with morally-based value judgments, we may end up perpetuating inequities in spite of our good intentions through what Solo calls inaction, non-choice and drifting (Solo, 1981, p. 38)

From the above discussion, one may easily notice the similarities and differences between the two disciplines. While the subject matter of both is the allocation and distribution of resources and both emphasize the fulfillment of material needs, there is an equal emphasis in Islamic economics on the fulfillment of spiritual needs. While both recognize the important role of market mechanism in the allocation and distribution of resources, Islamic economics argues that the market may not by itself be able to fulfill even the material needs of all human beings. This is because it can promote excessive use of scarce resources by the rich at the expense of the poor if there is undue emphasis on the serving of self-interest. Sacrifice is involved in fulfilling our obligations towards others and excessive emphasis on the serving of self-interest does not have the potential of motivating people to make the needed
sacrifice. This, however, raises the crucial question of why would a rational person sacrifice his self-interest for the sake of others?

**The Importance of the Hereafter**

This is where the concepts of the innate goodness of human beings and of the Hereafter come in - concepts which conventional economics ignores but on which Islam and other major religions place a great deal of emphasis. Because of their innate goodness, human beings do not necessarily always try to serve their self-interest. They are also altruistic and are willing to make sacrifices for the well-being of others. In addition, the concept of the Hereafter does not confine self-interest to just this world. It rather extends it beyond this world to life after death. We may be able to serve our self-interest in this world by being selfish, dishonest, uncaring, and negligent of our obligations towards our families, other human beings, animals, and the environment. However, we cannot serve our self-interest in the Hereafter except by fulfilling all these obligations.

Thus, the serving of self-interest receives a long-run perspective in Islam and other religions by taking into account both this world as well as the next. This serves to provide a motivating mechanism for sacrifice for the well-being of others that conventional economics fails to provide. The innate goodness of human beings along with the long-run perspective given to self-interest has the potential of inducing a person to be not only efficient but also equitable and caring. Consequently, the three crucial concepts of conventional economics - rational economic man, positivism, and laissez faire – were not able to gain intellectual blessing in their conventional economics sense from any of the outstanding scholars who represent the mainstream of Islamic thought.

**Rational Economic Man**

While there is hardly anyone opposed to the need for rationality in human behavior, there are differences of opinion in defining rationality (Sen, 1987, pp. 11-14). However, once rationality has been defined in terms of overall individual as well as social well-being, then rational behaviour could only be that which helps us realize this goal. Conventional economics did not define rationality in this way. It equates rationality with the serving of self-interest through the maximization of wealth and want satisfaction. The drive of self-interest was considered to be the “moral
equivalent of the force of gravity in nature” (Myers, 1983, p.4). Within this framework society came to be conceptualized as mere collection of individuals united through ties of self-interest.

The concept of ‘rational economic man’ in this social-Darwinist, utilitarian, and material sense of serving self-interest could not find a foothold in Islamic economics. ‘Rationality’ in Islamic economics does not get confined to the serving of one’s self-interest in this world alone; it also gets extended to the Hereafter through the faithful compliance with moral values that help rein self-interest to promote social interest. Al-Mawardi (d. 1058) considered it necessary, like all other Muslim scholars, to rein individual tastes and preferences through moral values (1955, pp. 118-20). Ibn Khaldun (d.1406) emphasized that moral orientation helps remove mutual rivalry and envy, strengthens social solidarity, and creates an inclination towards righteousness (n.d., p.158).

**Positivism**

Similarly, positivism in the conventional economics sense of being “entirely neutral between ends” (Robbins, 1935, p. 240) or “independent of any particular ethical position or normative judgment” (Friedman, 1953) did not find a place in Muslim intellectual thinking. Since all resources at the disposal of human beings are a trust from God, and human beings are accountable before Him, then there is no other option but to use them in keeping with the terms of trust. These terms are defined by beliefs and moral values. Human brotherhood, one of the central objectives of Islam, would be a meaningless jargon if it were not reinforced by justice in the allocation and distribution of resources.

**Pareto Optimum**

Without justice, it would be difficult to realize even development. Muslim scholars have emphasized this throughout history. Development Economics has also started emphasizing its importance, more so in the last few decades.² Abu Yusuf (d. 798) argued that: “Rendering justice to those wronged and eradicating injustice,

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² The literature on economic development is full of assertions that improvement in income distribution is in direct conflict with economic growth. For a summary of these views, see Cline, 1973, Chapter 2). This has, however, charged and there is hardly any development economist now who argues that injustice can help promote development.
raises tax revenue, accelerates development of the country, and brings blessings in addition to reward in the Hereafter” (1933/34, p. 111: see also pp. 3-17). Al-Mawardi argued that comprehensive justice “inculcates mutual love and affection, obedience to the law, development of the country, expansion of wealth, growth of progeny, and security of the sovereign” (1955, p. 27). Ibn Taymiyyah (d. 1328) emphasized that “justice towards everything and everyone is an imperative for everyone, and injustice is prohibited to everything and everyone. Injustice is absolutely not permissible irrespective of whether it is to a Muslim or a non-Muslim or even to an unjust person” (1961-63, Vol. 18, p. 166).

Justice and the well-being of all may be difficult to realize without a sacrifice on the part of the well-to-do. The concept of Pareto optimum does not, therefore, fit into the paradigm of Islamic economics. This is because Pareto optimum does not recognize any solution as optimum if it requires a sacrifice on the part of a few (rich) for raising the well-being of the many (poor). [It is the concept of Pareto optimum which prompted John Rawls to state that one must never act solely to increase general happiness, if in doing so one makes any person unhappy (Rawls, 1958)]. Such a position is in clear conflict with moral values, the raison d’être of which is the well-being of all. Hence, this concept did not arise in Islamic economics. In fact Islam makes it a religious obligation of Muslims to make a sacrifice for the poor and the needy, by paying Zakat at the rate of 2.5 per cent of their net worth. This is in addition to the taxes that they pay to the governments as in other countries.

The Role of State

Moral values may not be effective if they are not observed by all. They need to be enforced. It is the duty of the state to restrain all socially harmful behaviour including injustice, fraud, cheating, transgression against other people’s person, honour and property, and the non-fulfillment of contracts and other obligations through proper upbringing, incentives and deterrents, appropriate regulations, and an effective and impartial judiciary. The Qur’an can only provide norms. It cannot by itself enforce them. The state has to ensure this. That is why Prophet Muhammad said: “God restrains through the sovereign more than what He restrains through the Qur’an.” (Cited by al-Mawardi, 1955, p. 121). This emphasis on the role of the state

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3 North has used the term ‘nasty’ for all such behaviour. See the Chapter “Ideology and Free Rider,” in North, 1981.
has been reflected in the writings of all leading Muslim scholars throughout history.\(^4\) Al-Mawardi emphasized that an effective government (Sultan Qahir) is indispensable for preventing injustice and wrongdoing (1960, p.5). Say’s Law could not, therefore become a meaningful proposition in Islamic economics.

How far is the state expected to go in the fulfillment of its role? What is it that the state is expected to do? This has been spelt out by a number of scholars in the literature on what has come to be termed as “Mirrors for Princes.”\(^5\) None of them, visualized regimentation or the owning and operating of a substantial part of the economy by the state. Several classical Muslim scholars, including al-Dimashqi (d. after 1175) and Ibn Khaldun, clearly expressed their disapproval of the state becoming directly involved in the economy (Al-Dimashqi, 1977, pp. 12 and 61; Ibn Khaldun, pp. 281-3). According to Ibn Khaldun, the state should not acquire the character of a monolithic or despotic state resorting to a high degree of regimentation (Ibid., p. 188). It should not feel that, because it has authority, it can do anything it likes (ibid, p. 306). It should be welfare-oriented, moderate in its spending, respect the property rights of the people, and avoid onerous taxation (ibid, p. 296). This implies that what these scholars visualized as the role of government is what has now been generally referred to as ‘good governance’.

\(^4\) Some of these scholars include: Abu Yusuf (d. 798), al-Mawardi (d.1058), Abu Ya’la (d. 1065), Nazam al-Mulk (d.1092), al-Ghazali (d. 1111), Ibn Taymiyyah (d. 1328), Ibn Khaldun (d. 406), Shah Walliyullah (d. 1762), Jamaluddin al-Afghani (d. 1897), Muhammad ’Abduh (d. 1905), Muhammad Iqbal (d. 1938), Hasan al-Banna (d. 1949), Sayyid Mawdudi (d. 1979), and Baqir al-Sadr (d. 1980).

\(^5\) Some of these authors include: al-Katib (d.749), Ibn al-Muqaffa (d.756) al-Nu’man (d.974), al-Mawardi (d.1058), Kais Ka’us (d.1082), Nizam al-Mulk (d.1092), al-Ghazali (d.1111), al-Turtushi (d.1127). (For details, see Essid, 1995, pp.19-41).
III

SOME OF THE CONTRIBUTIONS MADE BY ISLAMIC ECONOMICS

The above discussion should not lead one to an impression that the two disciplines are entirely different. One of the reasons for this is that the subject matter of both disciplines is the same, allocation and distribution of scarce resources. Another reason is that all conventional economists have never been value neutral. They have made value judgments in conformity with their beliefs. As indicated earlier, even the paradigm of conventional economics has been changing - the role of good governance has now become well recognized and the injection of a moral dimension has also become emphasized by a number of prominent economists. Moreover, Islamic economists have benefited a great deal from the tools of analysis developed by neoclassical, Keynesian, social, humanistic and institutional economics as well as other social sciences, and will continue to do so in the future.

The Fallacy of the ‘Great Gap’ Theory

A number of economic concepts developed in Islamic economics long before they did in conventional economics. These cover a number of areas including interdisciplinary approach; property rights; division of labor and specialization; the importance of saving and investment for development; the role that both demand and supply play in the determination of prices and the factors that influence demand and supply; role of money, exchange, and market mechanism; characteristics of money, counterfeiting, currency debasement, and Gresham’s law; the development of cheques, letters of credit and banking; labour supply and population; the role of the state, justice, peace, and stability in development; and principles of taxation. It is not possible to provide a comprehensive coverage of all the contributions Muslim scholars made to economics. Only some of their contributions will be highlighted below to remove the concept of the “Great Gap” of “over 500 years” that exists in the history of conventional economic thought as a result of the false assumption by Joseph Schumpeter in his book, *History of Economic Analysis* (1954), that the intervening period between the Greeks and the Scholastics was sterile and
unproductive. This concept has become well embedded in the conventional economics literature as may be seen from the reference to this even by the Nobel Laureate, Douglas North, in his December 1993 Nobel lecture (1994, p. 365). Consequently, as Todd Lowry has rightly observed, “the character and sophistication of Arabian writings has been ignored” (See his ‘Foreword’ in Ghazanfar, 2003, p. xi).

The reality, however, is that the Muslim civilization which benefited greatly from the Chinese, Indian, Sassanian and Byzantine civilizations, itself made rich contributions to intellectual activity, including socio-economic thought, during the ‘Great Gap’ period, and thereby played a part in kindling the flame of the European Enlightenment Movement. Even the Scholastics themselves had been greatly influenced by the contributions made by Muslim scholars. The names of Ibn Sina (Avicenna, d. 1037), Ibn Rushd (Averroes, d. 1198) and Maimonides (d.1204) (a Jewish philosopher, scientist, and physician who flourished in Muslim Spain), appear on almost every page of the thirteenth century summa (treatises written by scholastic philosophers) (Pifer, 1978, p. 356).

**Multidisciplinary Approach for Development**

One of the most important contributions of Islamic economics, in addition to the above paradigm discussion, was the adoption of multidisciplinary dynamic approach. Muslim scholars did not focus their attention primarily on economic variables. They considered overall human well-being to be the end product of interaction over a long period of time between a number of economic as well as moral, social, political, demographic and historical factors in such a way that none of them is able to make an optimum contribution without the support of the others. Justice occupied a pivotal place in this whole framework because of its crucial importance in the Islamic worldview There was an acute realization that justice is indispensable for development and that, in the absence of justice, there will be decline and disintegration.

The contributions made by different scholars over the centuries seem to have reached their consummation in Ibn Khaldun’s *Maqaddimah*, which literally means ‘introduction’, and constitutes the first volume of a seven-volume history, briefly

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6 For the fallacy of the Great Gap thesis, see Mirakhor (1987); and Ghazanfar (2003), particularly the “Foreword” by Todd Lowry and the “Introduction” by Ghazanfar.
called Kitab al-'Ibar or the Book of Lessons [of History]. Ibn Khaldun lived at a time (1332-1406) when the Muslim civilization was in the process of decline. He wished to see a reversal of this tide, and, as a social scientist, he was well aware that such a reversal could not be envisaged without first drawing lessons ('ibar) from history to determine the factors that had led the Muslim civilization to bloom out of humble beginnings and to decline thereafter. He was, therefore, not interested in knowing just what happened. He wanted to know the how and why of what happened. He wanted to introduce a cause and effect relationship into the discussion of historical phenomena. The Muqaddimah is the result of this desire. It tries to derive the principles that govern the rise and fall of a ruling dynasty, state (dawlah) or civilization ('umran).

Since the centre of Ibn Khaldun’s analysis is the human being, he sees the rise and fall of dynasties or civilizations to be closely dependent on the well-being or misery of the people. The well-being of the people is in turn not dependent just on economic variables, as conventional economics has emphasized until recently, but also on the closely interrelated role of moral, psychological, social, economic, political, demographic and historical factors. One of these factors acts as the trigger mechanism. The others may, or may not, react in the same way. If the others do not react in the same direction, then the decay in one sector may not spread to the others and either the decaying sector may be reformed or the decline of the civilization may be much slower. If, however, the other sectors react in the same direction as the trigger mechanism, the decay will gain momentum through an interrelated chain reaction such that it becomes difficult over time to identify the cause from the effect. He, thus, seems to have had a clear vision of how all the different factors operate in an interrelated and dynamic manner over a long period to promote the development or decline of a society.

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7 The full name of the book (given in the Bibliography) may be freely translated as “The Book of Lessons and the Record of Cause and Effect in the History of Arabs, Persians and Berbers and their Powerful Contemporaries.” Several different editions of the Muqaddimah are now available in Arabic. The one I have used is that published in Cairo by al-Maktabah al-Tijarriyah al-Kubra without any indication of the year of publication. It has the advantage of showing all vowel marks, which makes the reading relatively easier. The Muqaddimah was translated into English in three volumes by Franz Rosenthal. Its first edition was published in 1958 and the second edition in 1967. Selections from the Muqaddimah by Charles Issawi were published in 1950 under the title, An Arab Philosophy of History: Selections from the Prolegomena of Ibn Khaldun of Tunis (1332-1406). A considerable volume of literature is now available on Ibn Khaldun. Some of this is: Spengler, 1964; Boulakia, 1971; Mirakhor, 1987; Chapra, 2000.
He did not, thus, adopt the neoclassical economists’ simplification of confining himself to primarily short-term static analysis of only the markets by assuming unrealistically that all other factors remain constant. Even in the short-run, everything may be in a state of flux through a chain reaction to the various changes constantly taking place in human society, even though these may be so small as to be imperceptible. Therefore, even though economists may adopt the *ceteris paribus* assumption for ease of analysis, Ibn Khaldun’s multidisciplinary dynamics can be more helpful in formulating socio-economic policies that help improve the overall performance of a society. Neoclassical economics is unable to do this because, as North has rightly asked, “How can one prescribe policies when one does not understand how economies develop?” He, therefore, considers neoclassical economics to be “an inappropriate tool to analyze and prescribe policies that will induce development” (North, 1994, p. 549).

However, this is not all that Islamic economics has done. Muslim scholars, including Abu Yusuf (d. 798), al-Mawardi (d. 1058), Ibn Hazm (d. 1064) al-Sarakhsi (d. 1090), al-Tusi (d. 1093), al-Ghazali (d. 1111),al-Dimashqi (d. after 1175), Ibn Rushd (d.1187), Ibn Taymiyyah (d.1328), Ibn al-Ukhuwwah (d.1329), Ibn al-Qayyim (d.1350), al-Shatibi (d. 1388), Ibn Khaldun (d. 1406), al-Maqrizi (d. 1442), al-Dawwani (d.1501), and Shah Waliyullah (d. 1762), made a number of valuable contributions to economic theory. Their insight into some economic concepts was so deep that a number of the theories propounded by them could undoubtedly be considered the forerunners of some more sophisticated modern formulations of these theories.  

**Division of Labor, Specialization, Trade, Exchange and Money and Banking**

A number of scholars emphasized the necessity of division of labour for economic development long before this happened in conventional economics. For example, al-Sarakhsi (d.1090) said: “the farmer needs the work of the weaver to get clothing for himself, and the weaver needs the work of the farmer to get his food and the cotton from which the cloth is made …, and thus everyone of them helps the other by his work…” (1978, Vol. 30, p. 264). Al-Dimashqi, writing about a century later, elaborates further by saying: “No individual can, because of the shortness of his life

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8 For some of these contributions, see Spengler, 1964; DeSmogyi, 1965; Mirakhor, 1987; Siddiqi, 1992; Essid, 1995; Islahi, 1996; Chapra, 2000; and Ghazanfar, 2003.
span, burden himself with all industries. If he does, he may not be able to master the
skills of all of them from the first to the last. Industries are all interdependent.
Construction needs the carpenter and the carpenter needs the ironsmith and the
ironsmith needs the miner, and all these industries need premises. People are,
therefore, necessitated by force of circumstances to be clustered in cities to help each
other in fulfilling their mutual needs” (1977, p. 20-1).

Ibn Khaldun ruled out the feasibility or desirability of self-sufficiency, and
emphasized the need for division of labor and specialization by indicating that: “It is
well-known and well-established that individual human beings are not by themselves
capable of satisfying all their individual economic needs. They must all cooperate for
this purpose. The needs that can be satisfied by a group of them through mutual
cooperation are many times greater than what individuals are capable of satisfying by
themselves” (p. 360). In this respect he was perhaps the forerunner of the theory of
comparative advantage, the credit for which is generally given in conventional
economics to David Ricardo who formulated it in 1817.

The discussion of division of labour and specialization, in turn, led to an
emphasis on trade and exchange, the existence of well-regulated and properly
functioning markets through their effective regulation and supervision (hisbah), and
money as a stable and reliable measure and medium of exchange and store of value.
However, because of bimetallism (gold and silver coins circulating together) which
then prevailed, and the different supply and demand conditions that the two metals
faced, the rate of exchange between the two full-bodied coins fluctuated. This was
further complicated by debasement of currencies by governments in the later centuries
to tide over their fiscal problems. This had, according to Ibn Taymiyyah (d.1328)
(1961-63, Vol. 29, p. 649), and later on al-Maqrizi (d.1442) and al-Asadi (d. 1450),
the effect of bad coins driving good coins out of circulation (al-Misri, 1981, pp. 54
and 66), a phenomenon which was recognized and referred to in the West in the 16th
century as Gresham’s Law. Since debasement of currencies is in sheer violation of the
Islamic emphasis on honesty and integrity in all measures of value, fraudulent
practices in the issue of coins in the 14th century and afterwards elicited a great deal of
literature on monetary theory and policy. The Muslims, according to Baeck, should,
therefore, be considered forerunners and critical incubators of the debasement
literature of the 14th and 15th centuries (Baeck, 1994, p.114).
To finance their expanding domestic and international trade, the Muslim world also developed a financial system, which was able to mobilize the “entire reservoir of monetary resources of the mediaeval Islamic world” for financing agriculture, crafts, manufacturing and long-distance trade (Udovitch, 1970, pp.180 and 261). Financiers were known as sarrafs. By the time of Abbasid Caliph al-Muqtadir (908-932), they had started performing most of the basic functions of modern banks (Fischel, 1992). They had their markets, something akin to the Wall Street in New York and the Lombard Street in London, and fulfilled all the banking needs of commerce, agriculture and industry (Duri, 1986, p. 898). This promoted the use of checks (sakk) and letters of credit (hawala). The English word check comes from the Arabic term sakk.

Demand and Supply

A number of Muslim scholars seem to have clearly understood the role of both demand and supply in the determination of prices. For example, Ibn Taymiyyah (d. 1328) wrote: "The rise or fall of prices may not necessarily be due to injustice by some people. They may also be due to the shortage of output or the import of commodities in demand. If the demand for a commodity increases and the supply of what is demanded declines, the price rises. If, however, the demand falls and the supply increases, the price falls" (1961-3, Vol. 8, p. 523).

Even before Ibn Taymiyyah, al-Jahiz (d. 869) wrote nearly five centuries earlier that: "Anything available in the market is cheap because of its availability [supply] and dear by its lack of availability if there is need [demand] for it" (1983, p. 13), and that "anything the supply of which increases, becomes cheap except intelligence, which becomes dearer when it increases" (ibid., p. 13).

Ibn Khaldun went even further by emphasizing that both an increase in demand or a fall in supply leads to a rise in prices, while a decline in demand or a rise in supply contributes to a fall in prices (pp. 393 and 396). He believed that while continuation of 'excessively low' prices hurts the craftsmen and traders and drives them out of the market, the continuation of 'excessively high' prices hurts the consumers. 'Moderate' prices in between the two extremes were, therefore, desirable, because they would not only allow the traders a socially-acceptable level of return but also lead to the clearance of the markets by promoting sales and thereby generating a
given turnover and prosperity (*ibid*, p. 398). Nevertheless, low prices were desirable for necessities because they provide relief to the poor who constitute the majority of the population (*ibid*, p. 398). If one were to use modern terminology, one could say that Ibn Khaldun found a stable price level with a relatively low cost of living to be preferable, from the point of view of both growth and equity in comparison with bouts of inflation and deflation. The former hurts equity while the latter reduces incentive and efficiency. Low prices for necessities should not, however, be attained through the fixing of prices by the state; this destroys the incentive for production (*ibid*, pp. 279-83).

The factors which determined demand were, according to Ibn Khaldun, income, price level, the size of the population, government spending, the habits and customs of the people, and the general development and prosperity of the society (*ibid*, pp. 398-404). The factors which determined supply were: demand (*ibid*, pp. 400 and 403), order and stability (pp. 306-308), the relative rate of profit (*ibid*, pp. 395 and 398), the extent of human effort (p. 381), the size of the labour force as well as their knowledge and skill (pp. 363 and 399-400), peace and security (pp. 394-5 and 396), and the technical background and development of the whole society (pp. 399-403). All these constituted important elements of his theory of production. If the price falls and leads to a loss, capital is eroded, the incentive to supply declines, leading to a recession. Trade and crafts also consequently suffer (p. 398).

This is highly significant because the role of both demand and supply in the determination of value was not well understood in the West until the late nineteenth and the early twentieth centuries. Pre-classical English economists like William Petty (1623-87), Richard Cantillon (1680-1734), James Steuart (1712-80), and even Adam Smith (1723-90), the founder of the Classical School, generally stressed only the role of the cost of production, and particularly of labour, in the determination of value. The first use in English writings of the notions of both demand and supply was perhaps in 1767 (Thweatt, 1983). Nevertheless, it was not until the second decade of the nineteenth century that the role of both demand and supply in the determination of market prices began to be fully appreciated (Groenewegen, 1973). While Ibn Khaldun had been way ahead of conventional economists, he probably did not have any idea of demand and supply schedules, elasticities of demand and supply and most important of all, equilibrium price, which plays a crucial role in modern economic discussions.
Public Finance

Taxation

Long before Adam Smith (d. 1790), who is famous, among other things, for his canons of taxation (equality, certainty, convenience of payment, and economy in collection) (See Adam Smith, 1937, pp. 777-9), the development of these canons can be traced in the writings of pre-Islamic as well as Muslim scholars, particularly the need for the tax system to be just and not oppressive. Caliphs Umar (d.644), Ali (d.661) and Umar ibn Abd al-Aziz (d.720), stressed that taxes should be collected with justice and leniency and should not be beyond the ability of the people to bear. Tax collectors should not under any circumstances deprive the people of the necessities of life (Abu Yusuf, 1933/34, pp. 14, 16 and 86). Abu Yusuf, adviser to Caliph Harun al-Rashid (786-809), argued that a just tax system would lead not only to an increase in revenues but also to the development of the country (Abu Yusuf, 1933/34, p. 111; see also pp. 14, 16, 60, 85, 105-19 and 125). Al-Mawardi also argued that the tax system should do justice to both the taxpayer and the treasury - "taking more was iniquitous with respect to the rights of the people, while taking less was unfair with respect to the right of the public treasury" (1960, p. 209; see also pp. 142-56 and 215).9

Ibn Khaldun stressed the principles of taxation very forcefully in the *Muqaddimah*. He quoted from a letter written by Tahir ibn al-Husayn, Caliph al-Ma’mun’s general, advising his son, 'Abdullah ibn Tahir, Governor of al-Raqqah (Syria): "So distribute [taxes] among all people making them general, not exempting anyone because of his nobility or wealth and not exempting even your own officials or courtiers or followers. And do not levy on anyone a tax which is beyond his capacity to pay" (p. 308).10 In this particular passage, he stressed the principles of equity and neutrality, while in other places he also stressed the principles of convenience and productivity.

The effect of taxation on incentives and productivity was so clearly visualized by Ibn Khaldun that he seems to have grasped the concept of optimum taxation. He anticipated the gist of the Laffer Curve, nearly 600 years before Professor Arthur

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9 For a more detailed discussion of taxation by various Muslim scholars, see the section on "Literature on Mirrors for Princes" in Essid, 1995, pp. 19-41.

10 This letter is a significant development over the letter of Abu Yusuf to Caliph Harun al-Rashid (1933/34, pp. 3-17). It is more comprehensive and covers a larger number of topics.
Laffer, in two full chapters of the *Mugaddimah*.\(^{11}\) At the end of the first chapter, he concluded that "the most important factor making for business prosperity is to lighten as much as possible the burden of taxation on businessmen, in order to encourage enterprise by ensuring greater profits [after taxes]" (p. 280). This he explained by stating that "when taxes and imposts are light, the people have the incentive to be more active. Business therefore expands, bringing greater satisfaction to the people because of low taxes ..., and tax revenues also rise, being the sum total of all assessments" (p. 279). He went on to say that as time passes the needs of the state increase and rates of taxation rise to increase the yield. If this rise is gradual people become accustomed to it, but ultimately there is an adverse impact on incentives. Business activity is discouraged and declines, and so does the yield of taxation (pp. 280-1). A prosperous economy at the beginning of the dynasty, thus, yields higher tax revenue from lower tax rates while a depressed economy at the end of the dynasty, yields smaller tax revenue from higher rates (p. 279). He explained the reasons for this by stating: "Know that acting unjustly with respect to people's wealth, reduces their will to earn and acquire wealth ... and if the will to earn goes, they stop working. The greater the oppression, the greater the effect on their effort to earn ... and, if people abstain from earning and stop working, the markets will stagnate and the condition of people will worsen" (pp. 286-7); tax revenues will also decline (p. 362). He, therefore, advocated justice in taxation (p. 308).

**Public Expenditure**

For Ibn Khaldun the state was also an important factor of production. By its spending it promotes production and by its taxation it discourages production (pp. 279-81). Since the government constitutes the greatest market for goods and services, and is a major source of all development (pp. 286 and 403), a decrease in its spending leads to not only a slackening of business activity and a decline in profits but also a decline in tax revenue (p. 286). The more the government spends, the better it may be for the economy (p. 286).\(^{12}\) Higher spending enables the government to do the things that are needed to support the population and to ensure law and order and political stability (pp. 306 and 308). Without order and political stability, the producers have

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\(^{11}\) These are: "On tax revenues and the reason for their being low and high" (pp. 279-80) and "Injustice ruins development" (pp. 286-410).

\(^{12}\) Bear in mind the fact that this was stated at the time when commodity money, which it is not possible for the government to ‘create’, was used, and fiduciary money had not become the rule of the day.
no incentive to produce. He stated that "the only reason [for the accelerated development of cities] is that the government is near them and pours its money into them, like the water [of a river] that makes green everything around it, and irrigates the soil adjacent to it, while in the distance everything remains dry" (p. 369).

Ibn Khaldun also analyzed the effect of government expenditure on the economy and is, in this respect, a forerunner of Keynes. He stated: "A decrease in government spending leads to a decline in tax revenues. The reason for this is that the state represents the greatest market for the world and the source of civilization. If the ruler hoards tax revenues, or if these are lost, and he does not spend them as they should be, the amount available with his courtiers and supporters would decrease, as would also the amount that reaches through them to their employees and dependents [the multiplier effect]. Their total spending would, therefore, decline. Since they constitute a significant part of the population and their spending constitutes a substantial part of the market, business will slacken and the profits of businessmen will decline, leading also to a decline in tax revenues ... Wealth tends to circulate between the people and the ruler, from him to them and from them to him. Therefore, if the ruler withholds it from spending, the people would become deprived of it" (p. 286).

**Economic Mismanagement and Famine**

Ibn Khaldun established the causal link between bad government and high grain prices by indicating that in the later stage of the dynasty, when public administration becomes corrupt and inefficient, and resorts to coercion and oppressive taxation, incentive is adversely affected and the farmers refrain from cultivating the land. Grain production and reserves fail to keep pace with the rising population. The absence of reserves causes supply shortages in the event of a famine and leads to price escalation (pp. 301-2).

Al-Maqrizi (d.1442) who, as muhtasib (market supervisor), had intimate knowledge of the economic conditions during his times, applied Ibn Khaldun's analysis in his book (1956) to determine the reasons for the economic crisis of Egypt during the period 1403-6. He identified that the political administration had become very weak and corrupt during the Circassian period. Public officials were appointed
on the basis of bribery rather than ability.\textsuperscript{13} To recover the bribes, officials resorted to oppressive taxation. The incentive to work and produce was adversely affected and output declined. The crisis was further intensified by debasement of the currency through the excessive issue of copper \textit{fulus}, or fiat money, to cover state budgetary deficits. All these factors joined hands with the famine to lead to a high degree of inflation, misery of the poor, and impoverishment of the country.

Hence, al-Maqrizi laid bare the socio-political determinants of the prevailing 'system crisis' by taking into account a number of variables like corruption, bad government policies, and weak administration. All of these together played a role in worsening the impact of the famine, which could otherwise have been handled effectively without a significant adverse impact on the population. This is clearly a forerunner of Sen's entitlement theory, which holds the economic mismanagement of illegitimate governments to be responsible for the poor people's misery during famines and other natural disasters (Sen, 1981). What al-Maqrizi wrote of the Circassian Mamluks was also true of the later Ottoman period (See Meyer, 1989).

\textbf{Stages of Development}

Ibn Khaldun stated the stages of development through which every society passes, moving from the primitive bedouin stage to the rise of village, towns and urban centres with an effective government, development of agriculture, industry and sciences, and the impact of values and environment on this development (\textit{Muqaddimah}, pp. 35, 41-44, 87-95, 120-148, 172-176). Walliyullah\textsuperscript{14} (d.1762) also analyzed the development of society later on through four different stages from primitive existence to a well-developed community with \textit{khilafah} (morally-based welfare state), which tries to ensure the spiritual as well as material well-being of the people. Like Ibn Khaldun, he considered political authority to be indispensable for human well-being. To be able to serve as a source of well-being for all and not of burden and decay, it must have the characteristics of the \textit{khilafah}. He applied this

\textsuperscript{13} This was during the Slave (Mamluk) Dynasty in Egypt, which is divided into two periods. The first period was that of the Bahri (or Turkish) Mamluks (1250-1382), who have generally received praise in the chronicles of their contemporaries. The second period was that of the Burji Mamluks (Cirassians, 1382-1517). This period was beset by a series of severe economic crises. (For details see Allouche, 1994.)

\textsuperscript{14} Shah Walliyullah al-Dihlawi, popularly known as Walliyullah, was born in 1703, four years before the death of the Mughal Emperor, Aurangzeb (1658-1707). Aurangzeb's rule, spanning a period of 49 years, was followed by a great deal of political instability - 10 different changes in rulers during Walliyullah's life-span of 59 years - leading ultimately to the weakening and decline of the Mughal Empire.
analysis in various writings to the conditions prevailing during his life-time. He found that the luxurious life style of the rulers, along with their exhausting military campaigns, the increasing corruption and inefficiency of the civil service, and huge stipends to a vast retinue of unproductive courtiers, led them to the imposition of oppressive taxes on farmers, traders and craftsmen, who constituted the main productive section of the population. These people had, therefore, lost interest in their occupations, output had slowed down, state financial resources had declined, and the country had become impoverished (Waliyullah, 1992, Vol. I, pp. 119-52.). Thus, in step with Ibn Khaldun and other Muslim scholars, al-Maqrizi and Waliyullah combined moral, political, social and economic factors to explain the economic phenomena of their times and the rise and fall of their societies.

Muslim Intellectual Decline

Unfortunately, the rich theoretical contribution made by Muslim scholars up until Ibn Khaldun did not get fertilized and irrigated by later scholars to lead to the development of Islamic economics, except by a few isolated scholars like al-Maqrizi, al-Dawwani (d.1501), and Waliyullah. Their contributions were, however, only in specific areas and did not lead to a further development of Ibn Khaldun's model of socio-economic and political dynamics. Islamic economics did not, therefore, develop as a separate intellectual discipline in conformity with the Islamic paradigm along the theoretical foundations and method laid down by Ibn Khaldun and his predecessors. It continued to remain an integral part of the social and moral philosophy of Islam.

One may ask here why the rich intellectual contributions made by Muslim scholars did not continue after Ibn Khaldun. The reason may be that, as indicated earlier, Ibn Khaldun lived at a time when the political and socio-economic decline of the Muslim world was underway. He was perhaps "the sole point of light in his quarter of the firmament" (Toynbee, 1935, Vol. 3, p. 321). According to Ibn Khaldun himself, sciences progress only when a society is itself progressing (p. 434). This theory is clearly upheld by Muslim history. Sciences progressed rapidly in the Muslim world for four centuries from the middle of the eighth century to the middle of the twelfth century and continued to do so at a substantially decelerated pace for at

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15 For a brief account of the general decline and disintegration of the Muslim world during the fourteenth century, see Muhsin Mahdi, 1964, pp. 17-26.
least two more centuries, tapering off gradually thereafter. (Sarton 1927, Vol. 1 and Book 1 of Vol. 2). Once in a while there did appear a brilliant star on an otherwise unexciting firmament. Economics was no exception. It also continued to be in a state of limbo in the Muslim world. No worthwhile contributions were made after Ibn Khaldun.

The trigger mechanism for this decline was, according to Ibn Khaldun, the failure of political authority to provide good governance. Political illegitimacy, which started after the end of *khilafah* in 661 gradually led to increased corruption and the use of state resources for private benefit at the neglect of education and other ration-building functions of the state. This gradually triggered the decline of all other sectors of the society and economy.\(^\text{16}\)

The rapidly rising Western civilization took over the torch of knowledge from the declining Muslim world and has kept it burning with even greater brightness. All sciences, including the social sciences, have made phenomenal progress. Conventional economics became a separate academic discipline after the publication of Alfred Marshall’s great treatise, *Principles of Economics*, in 1890 (Schumpeter, 1954, p.21)\(^\text{17}\), and has continued to develop since then at a remarkable speed. With such a great achievement to its credit, there is no psychological need to allow the ‘Great Gap’ thesis to persist. It will help promote better understanding of the Muslim civilization in the West if textbooks start giving credit to Muslim scholars. They were “the torchbearers of ancient learning during the medieval period” and “it was from them that the Renaissance was sparked and the Enlightenment kindled” (Todd Lowry in his ‘Foreword’ in Ghazanfar, 2003, p. xi). Watt has been frank enough to admit that, “the influence of Islam on Western Christendom is greater than is usually realized” and that, “an important task for Western Europeans, as we move into the era of the one world, is … to acknowledge fully our debt to the Arab and Islamic world” (Watt, 1972, p. 84).

Conventional economics, however, took a wrong turn after the Enlightenment Movement by stripping itself of the moral basis of society emphasised by Aristotelian and Judo-Christian philosophies. This deprived it of the role that moral values and good governance can play in helping the society raise both efficiency and

\(^{16}\) For a discussion of the causes of Muslim decline, see Chapra, 2000, pp. 173-252.

\(^{17}\) According to Blaug (1985), economics became an academic discipline in the 1880s (p. 3).
equity in the allocation and distribution of scarce resources needed for promoting the well-being of all. However, this has been changing. The role of good governance has already been recognized and that of moral values is gradually penetrating the economics orthodoxy. Islamic economics is also reviving now after the independence of Muslim countries from foreign domination. It is likely that the two disciplines will converge and become one after a period of time. This will be in keeping with the teachings of the Qur’an, which clearly states that mankind was created as one but became divided as a result of their differences and transgression against each other (10:19, 2:213 and 3:19). This reunification, as it is now called, if reinforced by justice and mutual care, should help promote peaceful coexistence and enable mankind to realize the well-being of all, a goal the realization of which we are all anxiously looking forward to.
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