# Comments of

## Mohammed Ariff*

**on**

**Islamic Economics and Finance: Where Do They Stand?**

**by Masudul Alam Choudhury**

**and**

**Redistributive Justice in a Developed Economy: An Islamic Perspective**

**by Mabid Ali Al-Jarhi**

**Comments on "Islamic Economics and Finance: Where Do They Stand?"** The paper by Prof. Masudul Alam Choudhury is not an easy paper to read. It is a highly philosophical and intellectually sophisticated piece of work that requires more than careful reading. It is even more difficult to comment on the paper, as it is tightly argued with hardly any space for serious criticisms. I find myself generally in tandem with the tenor and conclusions of the paper.

Prof. Choudhury raises highly pertinent questions and throws formidable challenges at economists who are re-inventing Western economic theories and empiricism ostensibly in the name of Islam. Arguably, most, if not all, of the contemporary writings in the realm of Islamic Economics are products of unimaginative application of analytical tools of conventional economics in the Islamic domain. The author argues very persuasively and convincingly that the Islamic worldview is premised on a distinctive epistemology and the Tawhidi dynamics of Islam call for an entirely different approach, while Islamic economics and finance have fallen unwittingly into the trap of neo-classical and neo-liberal doctrinaire.

The problem is glaringly conspicuous in the case of Islamic finance which is now in the danger of being completely absorbed if not hijacked by the West. It has become fashionable for Western banks to have Islamic extensions, motivated purely by the desire to have a share in the growing market for Islamic funds. Islamic banking has devolved into yet another addition that contributes to the diversity of financial instruments in the global market. It now appears that as if the elimination of interest is the end-all and be-all of Islamic finance. It can also be argued that the elimination of interest is more apparent than real. Islamic finance is in the danger of seeking solace in the letter rather than the spirit of Islamic injunctions. Islamic financial instruments are overtly "interest-free" but remain covertly "interest-based" to the extent the cost of funds and returns on deposits are guided by the prevailing interest rate structure of conventional banking. Seen in such terms, it is readily obvious that Islamic banks have been unwittingly admitting interest rates through the back door.

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The Islamic economic system differs sharply from other contemporary economic system so much so that Western concepts, notions, ideas and instruments are inapplicable without radical modifications. The moral values and the ethical norms of Islam do significantly influence the mode of economic behavior of Muslims in an Islamic society. To the extent that economics is a behavioral science, it must reflect such behavior. What makes an Islamic economy different from other economies is its value system which influences its consumption, production, saving, investment and redistribution decisions.

Does all this provide a valid basis for rejecting all conventional tools of analysis as irrelevant or inappropriate for Islamic economics and finance? I am not so sure. This is not to deny that there are many concepts in conventional economics that are steeped in Protestant values such as the notion of profit maximization. But, how about concepts and terms that are neutral or value-free, such as elasticity and equilibrium, which are borrowed from Physics? Care must however be taken to be wary of seemingly benign concepts such as "optimality". For what may constitute an optimal solution in one situation may well be sub-optimal in another, depending on the set of criteria which are not necessarily value-free. Thus, for instance, Pareto optimality is based on a distributive justice according to which no one should be made worse-off, so as to avoid inter-personal comparisons. Pareto optimality is thus too restrictive to be a guide for redistribution in an Islamic economy, which is far more egalitarian in both letter and spirit.

Prof. Choudhury's concerns are not about just concepts and terms per se, but about relationships and interactions among them (methods and methodology) in the Islamic framework, in contrast to the mainstream economics. He is certainly breaking new grounds. He shows that preference aggregation in mainstream economics differs from that in Islamic economics. He differentiates financial savings (a return on which is interest) in the mainstream context (where the financial sector is separated from the real sector of the economy) from participatory injection of capital into the real economy in the Islamic mode. He thus demonstrates the uniqueness of the Tawhidi approach, which is premised on inherent complementary participation of factors and enterprise. This leads him to argue that the dichotomy between macroeconomics and microeconomics is untenable in the Islamic framework. What is more, he questions the use of the present-valuation of cash flows method and the time value of money by Islamic economists and shows that the time valuation of money is no more than the shadow price of interest rate.

Given the Tawhidi principle of pervasive complementarities, there is unity between money and real economy and consequently there is only positive relationship between the rate of return and output. This is in sharp contrast to the Keynesian-Hicksian IS-curve of general equilibrium analysis.

Finally, the author looks critically at Islamic banking and insurance in practice. He takes existing Takaful to task for fixing insurance premium by distant future estimation of risk, which is tantamount to interest or *riba* as it smacks of pricing of unknown futures. On Islamic banking, his main criticism is that their activities are based on mechanistic understanding of the Shariah. He stops short of scrutinizing the extent to which these institutions have distanced themselves from the institution of interest in both letter and spirit.

I have learned much from the paper, which I found very refreshing. I wish to congratulate the author on a job well done.

**Comments on "Redistributive Justice in a Developed Economy: An Islamic Perspective"**

The paper by Dr Mabid Al-Jarhi and Dr Anas Zarqa represents a valuable addition to the literature on the subject. It tries to make a clear demarcation between the conventional approach and the Islamic one on the issue of redistribution of income and wealth.

However, I am not at ease with the title of the paper with speaks of redistributive justice in a “developed economy”. On the one hand, the title renders the paper somewhat irrelevant, as there is not a single country in the Islamic world belonging to the category of developed economies. On the other hand, the issues addressed in the paper are by no means specific to the developed economy status. That said, I must hasten to add that the paper is fairly well balanced both in terms of theoretical and empirical observations and in terms of pros and cons. The survey of the literature on redistribution, especially fairness models, is indeed commendable.

The authors have taken pains to debunk the notion that equity and efficiency cannot coexist. In this regard, the Malaysian experience with the New Economic Policy 1970-90 is instructive. Contrary to the common perception that bigger slices for some must mean smaller slices for others, Malaysia was able to demonstrate that it is possible for some to have bigger slice without others having smaller ones. The Malaysian affirmative policy was based not on the principle of disruptive redistribution of the existing pie but premised on active engagement of the disadvantaged in the expansion of the pie, so that everyone is better off and no one is worse off. This is clearly a case of greater equity in a growing economy. Quality growth is one that comes with equitable distribution.

The discussion of Pareto optimality is somewhat intriguing. It is argued that in a perfectly competitive economy redistribution from the rich to the poor would improve aggregate efficiency, provided the rich spend more on goods with relatively inelastic supply and the poor spend more on goods with relatively elastic supply. The logic is that income redistribution raises aggregate demand, which in turn raises aggregate supply. Much obviously would hinge on income-elasticity of demand and price-elasticity of supply. The authors stop short of questioning the Pareto optimality itself.

The notion of Islamic brotherhood (where one wishes for his brother what he wishes for himslelf) opens up new avenues in welfare economic analysis. Much would, of course, depend on the degree of benevolence one assumes. The degree of benevolence refers to how an individual equates his personal welfare with that of another. If A regards a dollar increase in B’s welfare as being equivalent to a dollar increase in his own welfare, there is 100 per cent benevolence, so that A’s benevolence coefficient reaches unity on the benevolence scale, implying that A is completely unselfish. Conversely, if B’s improved welfare means nothing to A, the benevolence coefficient of A is zero, implying that A is totally selfish. Worse still, if B’s improved welfare causes A to be unhappy, the latter’s benevolence coefficient is negative, implying that A is malevolent toward B.

The Pareto welfare criteria implicitly assume a zero benevolence coefficient. The said criteria would become less stringent if one permits benevolence, and more stringent if one admits malevolence, into the analysis. Thus, the Pareto condition that at least one person is better off without others being worse-off is valid, if and only if one assumes that others are not malevolent toward the individual who is now better off. Of course, Islam does not condone malevolence. But, the concept of welfare in Islamic economic system is different from conventional welfare economics. According to the latter, if A’s gain exceeds B’s loss so that A can profitably compensate B, the aggregate welfare of the community as a whole increases, even without A having to *actually* compensate B. In the Islamic sense, however, the change may signify a turn for the worse, if A is very rich and B is very poor, unless B is compensated *adequately*. Adequate compensation would depend on the relative position of A and B along the wealth distribution scale. This inevitably leads to the question of interpersonal comparisons which economists seek to avoid. But, social justice calls for interpersonal comparisons and economists can play a meaningful role as social scientists by positively responding to this call.

I find the section on redistribution in Islam most interesting. The authors have put forward a very persuasive argument for distribution in an Islamic framework. Their discussion of the institution of zakah in particular is quite extensive. However, the modalities and strategies considered in the paper can only help alleviate, but not eradicate, poverty. Redistribution of income from the rich to the poor would only amount to income transfers for consumptive purposes and will probably keep the poor in a state of poverty for ever. The use of zakah funds to equip the poor with new means of making a living and thereby generating income and creating wealth on their own would help convert zakah receivers into zakah payers over time.

As the authors have shown, actual zakah proceeds are way below potentials. This is largely because, zakah collection and distribution is yet to be properly institutionalized in the Muslim world. Although zakah bodies do exist in many countries, none is run like the way income tax revenue is organized. One of the reasons why so little zakah is collected in most countries is that many zakah payers prefer to distribute on the own, which in turn in due to the dismal record of many zakah collecting agencies which have failed to distribute the proceeds fully.

The paper falls short of discussing the international dimension of zakah collection and distribution. After all, Ummah is borderless. There is considerable economic disparity among the countries in the Muslim world. In some countries, more zakah can be collected than what is needed for redistribution. The reverse is true for many countries especially in Africa, where the “demand” for zakah funds far exceeds the “supply” of zakah funds. There is certainly a need for a supranational zakah institution to shift zakah funds from “surplus” countries to “deficit” countries under the auspices of the Organization of Islamic Conference (OIC)

All these notwithstanding, the paper by Dr Al-Jarhi and Dr Anas Zarqa has given us much food for thought. I would like to thank them for an intellectually stimulating paper.