



**NATIONAL OPEN UNIVERSITY OF NIGERIA**

**INTRODUCTION TO ISLAMIC ECONOMICS  
COURSE CODE: ECO 731**

**FACULTY OF SOCIAL SCIENCES  
DEPARTMENT OF ECONOMICS**

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## **Introduction**

Welcome to ECON: 731 INTRODUCTION TO ISLAMIC ECONOMICS

ECO 731: Introduction to Islamic Economics is a two-credit (2 credits units) and one-semester postgraduate course for students of Economics. The course is made up of twelve units spread across twelve lectures weeks. This course guide provides an insight in to the Islamic economics as a discipline as well as a system. It guides students on how to study the course materials to achieve the goal of teaching it. Specific guidelines were provided for the time required on each course unit in order to realise the outcomes of the course. Answers to your Tutor Marked Assignments (TMAs) are therein already.

## **Course Content**

This course introduces students to fundamentals and principles of Islamic economics and finance, Islamic economic system as an alternative to conventional economics, philosophical and moral foundations of the discipline among others. The course also introduces the micro and macroeconomics analysis from Islamic perspective including consumer behaviour, producer behaviour, market structure, role of the state in the economy, fiscal and monetary policies, aggregate demand and supply, halal economy. It also presents various stages of distribution in an Islamic economic system, social security system and Islamic banking and finance among others. The increasing recognition of Islamic finance makes it; according to International Monetary Fund (IMF); a systematically important Islamic economics in member countries. The system is found to be more resilience and more stable compared to interest based financial system. Hence, understanding it will go along way in achieving sustainable development goals such as poverty and hunger reduction, empowerment of women and youth.

## **Course Aims**

The aim of this course is to give you in-depth understanding of the development as regards:

- Development of Islamic economics and its rationales
- World views and the role of religion in economics
- Broad meaning of knowledge
- Sources of sharia and its application in economics
- Islamic economic system
- Basic principles of Islamic economics
- Features of Islamic economics
- How Islamic economics addresses the questions of how to produce, for whom to produce and how to distribute
- Philosophical foundations of Islamic economic system
- Operational principles of Islamic economics system
- Goals of Islamic economics system
- The role of al Hisba in regulating the economy
- Micro and macroeconomic analysis
- Consumer and producer behaviours
- Market mechanism from Islamic perspective
- Money, interest, gharar and maysir.

### **Course Objectives**

To achieve the aims of this course, there are overall objectives which the course is out to achieve though, there are set out objectives for each unit. The unit objectives are included at the beginning of a unit; you should read them before you start working through the unit. You may want to refer to them during your study of the unit to check on your progress. You should always look at the unit objectives after completing a unit. This is to assist the students in accomplishing the tasks entailed in this course. In this way, you can be sure you have done what was required of you in each unit. The objectives serves as study guides, such that student could know if he is able to grab the knowledge of each unit through the sets of objectives in each one. At the end of the course period, the students are expected to be able to:

- Describe Islamic economics as a discipline
- Discuss Development of Islamic economics and its rationales
- Explain the different world views and the role of religion in economics
- Discuss the Islamic perspective on knowledge, religion, existence of Allah, man and his environment as well purpose of life
- Define broadly the meaning of knowledge
- Identify and discuss the sources of sharia and its application in economics

- Discuss the rationales for the prohibition on interest, gharar and maysir.
- Explain the types and nature of contracts in Islamic finance
- Describe Islamic economic system
- Distinguish between Islamic economic system and other economic system
- Examine the basic principles of Islamic economics
- List and explain the features of Islamic economics
- Provide answers on how Islamic economics addresses the questions of how to produce, for whom to produce and how to distribute
- Analyse the philosophical foundations of Islamic economic system
- Discuss the operational principles of Islamic economics system
- Identify the goals of Islamic economics system
- Explain the role of al Hisba in regulating the economy
- Distinguish between micro and macroeconomics
- Discuss the consumer and producer behaviours
- Analyse market mechanism from Islamic perspective
- Explain the concept of welfare,

### **Working through the Course**

To successfully complete this course, you are required to read the study units, referenced books and other materials on the course.

Each unit contains self-assessment exercises called Student Assessment Exercises (SAE). At some points in the course, you will be required to submit assignments for assessment purposes. At the end of the course there is a final examination. This course should take about 15 weeks to complete and some components of the course are outlined under the course material subsection.

### **Course Material**

The major component of the course, What you have to do and how you should allocate your time to each unit in order to complete the course successfully on time are listed follows:

1. Course guide
2. Study unit

3. Textbook
4. Assignment file
5. Presentation schedule

## **Study Unit**

There are 12 units in this course which should be studied carefully and diligently.

### **MODULE ONE: OVERVIEW OF ISLAMICS ECONOMICS AND FINANCE**

UNIT 1: Development of Islamic economics and its rationales

UNIT 2: World views and the role of religion in economics

UNIT 3: Methodology, Sources of Sharia and prohibited elements

### **MODULE TWO: ISLAMIC ECONOMIC SYSTEM**

UNIT 1: Features of Islamic Economic System and other Systems

UNIT 2: Philosophical Foundations, Operational Principles and Goals

UNIT 3 : The Role of al-Hisba in Regulating the economy

### **MODULE THREE: INTRODUCTION TO MICRO AND MACRO ECONOMICS ANALYSIS**

UNIT 1 Consumer and Producer behaviours

UNIT 2 Market mechanism from Islamic perspective

UNIT 3 Islamic Macroeconomics Objectives, Fiscal and Monetary Policies

### **MODULE FOUR:INTRODUCTION TO ISLAMIC WELFARISM**

UNIT 1: Appraisal of Conventional Welfare Theory

- i. Concept of Welfare
- ii. Islamic Welfare Function

UNIT 2: Distribution in Islamic Economics

- i. Goals of Distribution in Islamic Economics
- ii. Functional Distribution in Islamic Economics

UNIT 3: Redistribution in Islamic Economics

- i. Zakat
- ii. Waqf
- iii. Sadaqah, Inheritance, Gift etc

Each study unit requires minimum of two hours. The scope covers introduction, objective (s), content, self-assessment exercise, conclusion, summary, references used and Tutor-Marked Assessment (TMA) questions.

For some of these questions, there is the need for group discussions, brainstorming sessions and arguments with some of your colleagues. Additionally, list of relevant materials both online and offline are provide for further reading and in-depth understanding of the subject matter so that the objectives of the module would be achieved.

### **Textbook and References**

Recommended materials for further reading are as follows:

Ahmed, H and Hoque, M. (2010). *Handbook of Islamic Economics-Exploring the Essence of Islamic Economics* (edit), IRTI.

Aliyu, Chika U. (2014) *Teaching of Economics, Research and Publications*, A paper prepared for presentation at the Special Plenary session on Teaching of Economics, Research and Publication at the 55<sup>th</sup> Annual Conference of the Nigerian Economic Society in Abuja, November, 11<sup>th</sup> – 13<sup>th</sup>, 2014

Aliyu, S. U. R., Idris, M. & Isma'il, A. A. (2013). *Readings in Islamic economics* (Eds.). Kano: International Institute of Islamic Banking and Finance (IIIBF), BUK.

Ashafa, S. A. (2014). The administration of Zakat in Lagos and Ogun states. *Research on Humanities and Social Sciences*, 4(21), 74-87.

Chapra, M. U. (1979). *Objectives of Islamic economic order*. London: The Islamic Foundation.

Chapra, M. U. (1992). *Islam and the economic challenge*. London: The Islamic Foundation and Washington D. C.: The International Institute of Islamic Thought (IIIT).

Chapra, M. U. (2001). *What is Islamic economics?* Jeddah: Islamic Research and Training Institute.

Faridi, F. R. (1983). Theory of fiscal policy in an Islamic state. In Z. Ahmed, M. Iqbal, & Khan, M.F. (Eds.), *Fiscal policy and resource allocation in Islam*. Islamabad: Institute of Policy Studies.

Galadanci, S. A. (1998). Islamic education in Africa: Past influence and future challenges. In N. Alkali, A. Adamu, A., Yadudu, R. Moten, & H. Salihi (Eds.). *Islam in Africa: Proceedings of Islam in Africa*. Ibadan: Spectrum Books Ltd.

Haneef, Aslam (2013). Teaching of Islamic Economics and Finance: The Human Resource Dimension. A Keynote address at the 1<sup>st</sup> World Congress on Integration and Islamization of Acquired Human Knowledge, Kuala Lumpur.

Haneef, Aslam (2013). Teaching of Islamic Economics at IIUM: The Challenges of Integration and Islamization (edit) in *Islamic Economics Education in South East Asian Universities*, IIIUM



- Hasan, Z. (2016). The evolution of Islamic economics: A critical analysis. *ISRA International Journal of Islamic Finance*, 8(2), 9-25.
- Haniza, K. Barom, M and Shirazi (2016) Essential Perspectives in Islamic Economics and Finance. IRTI and IIUM
- Islahi, A. (2008). Shehu Uthman Dan Fodio and his economic ideas, Online at <http://mpira.ub.uni-muenchen.de/40916/> MPRA Paper No. 40916, posted 29. August 2012 04:28 UTC
- Khan, M. A. (1994). *An introduction to Islamic economics*. Islamabad: International Institute of Islamic Thought (IIIT) and Institute of Policy Studies.
- Yasin, H. and Khan, A. (2016). Fundamentals of Islamic Economics and Finance, IRTI
- Lamido, A. A. (2013). Islamic economics: Early history and recent developments. In S.U.R. Aliyu, M. Idris & Isma'il, A.A. (Eds.), *Readings in Islamic economics* (pp. 14-29). Kano: International Institute of Islamic banking and Finance (IIIBF).
- Mohammed, Mustafa O. (2013) Integrating Al-Turath al-Islami to Modern University Curriculum: Issues and the Need for a Benchmark in Baron, Yusop, Haneef and Mohammed (edit) *Islamic Economics Education in South East Asian Universities*, IIUM
- Muhammad A. Abdullahi, M. (2016). Assessing the need of Islamic Economics Curriculum in the Nigerian Universities: The Case of Bayero University Kano, *IIUM Journal of Educational Studies*, vol 4, Issue 2, 2016.
- Mustafa, D. A. & Idris, M. (2015). The contributions of Islamic economics and institutions to modern Nigeria. *Journal of Islam in Nigeria* (JOIN) – Maiden edition, 1(1), 36-58.
- Mustafa, D. A. (2013). Principles of Islamic monetary policy. In S.U.R. Aliyu, M. Idris & Isma'il, A.A. (Eds.), *Readings in Islamic economics* (pp. 57-72). Kano: International Institute of Islamic banking and Finance (IIIBF).
- Shinsuke, N. (2012). Critical overview of the history of Islamic economics: Formation, transformation, and new horizons. *Asian and African Area Studies*, 11(2), 114-136.
- Siddiqi, M. N. (2008). *Obstacles to research in Islamic economics*. The Seventh International Conference on Islamic Economics – Thirty Years of Research in Islamic Economics, Solutions & Applications of Contemporary Economic Issues. Organized by King Abdulaziz University, IRTI, IDB, Islamic Economic Research Centre and the International Association for Islamic Economics (24-28 Rabiul-Awwal, 1429H/1-3 April, 2008G).
- Sulaiman, S. (2001). An appraisal of the Islamization of knowledge programme in Nigeria. *Al-Ijtihad: The Journal of Islamization of Knowledge and Contemporary Issues*, 2(1), 3-25.

Suryani (2012). The significance of Islamic economics study in discipline of modern economics. *Journal of Indonesian Economy and Business*, 27(1), 111-121.

### **Assignment File**

Assignment files and marking scheme will be made available to you. This file presents you with details of the work you must submit to your tutor for marking. The marks you obtain from these assignments shall form part of your final mark for this course. Additional information on assignments will be found in the assignment file and later in this Course Guide in the section on assessment.

There are four assignments in this course. The four course assignments will cover:

Assignment 1 - All TMAs' question in Units 1 – 3 (Module 1)

Assignment 2 - All TMAs' question in Units 4 – 6 (Module 2)

Assignment 3 - All TMAs' question in Units 7 – 9 (Module 3)

Assignment 4 - All TMAs' question in Units 10 – 12 (Module 4)

### **Presentation Schedule**

The presentation schedule is included in the course materials and gives specific dates and guidelines for its completion. You are required to observe the dates and those guidelines to submit a standard quality work for assessment.

### **Assessment**

For this course there are two types of assessment i.e tutor marked assignments and written examination at the end of the semester. In attempting the assignments, you are expected to apply information, knowledge and techniques gathered during the course. The assignments must be submitted to your tutor for formal Assessment in accordance with the deadlines stated in the Presentation Schedule and the Assignments File. The work you submit to your tutor for assessment will count for 30 % of your total course mark.

At the end of the course, you will need to sit for a final written examination of three hours' duration. This examination will also count for 70% of your total course mark.

## **Tutor-Marked Assignments (TMAs)**

There are four tutor-marked assignments in this course. You will submit all the assignments. You are encouraged to work all the questions thoroughly. The TMAs constitute 30% of the total score.

Assignment questions for the units in this course are contained in the Assignment File. You will be able to complete your assignments from the information and materials contained in your set books, reading and study units. However, it is desirable that you demonstrate that you have read and researched more widely than the required minimum. You should use other references to have a broad viewpoint of the subject and also to give you a deeper understanding of the subject.

When you have completed each assignment, send it, together with a TMA form, to your tutor. Make sure that each assignment reaches your tutor on or before the deadline given in the Presentation File. If for any reason, you cannot complete your work on time, contact your tutor before the assignment is due to discuss the possibility of an extension. Extensions will not be granted after the due date unless there are exceptional circumstances.

## **Final Examination and Grading**

The final examination will be of two hours' duration and have a value of 70% of the total course grade. The examination will consist of questions which reflect the types of self-assessment practice exercises and tutor-marked problems you have previously encountered. All areas of the course will be assessed

Revise the entire course material using the time between finishing the last unit in the module and that of sitting for the final examination to. You might find it useful to review your self-assessment exercises, tutor-marked assignments and comments on them before the examination. The final examination covers information from all parts of the course.

## **Course Marking Scheme**

The Table presented below indicates the total marks (100%) allocation.

<b>Assignment</b>	<b>Marks</b>
Assignments (Best three assignments out of four)	30%

that is marked)	
Final Examination	70%
<b>Total</b>	<b>100%</b>

### Course Overview

The Table presented below indicates the units, number of weeks and assignments to be taken by you to successfully complete the course, Environment and Sustainable Development (DES 211).

Units	Title of Work	Week's Activities	Assessment (end of unit)
	Course Guide		
<b>Module 1: OVERVIEW OF ISLAMICS ECONOMICS AND FINANCE</b>			
1	Development of Islamic economics and its rationales	Week 1	Assignment 1
2	World views and the role of religion in economics	Week 2	Assignment 2
3	Methodology, Sources of sharia	Week 3	Assignment 3
<b>Module 2: ISLAMIC ECONOMIC SYSTEM</b>			
4	Features of Islamic Economic System and other Systems	Week 5	Assignment 1
5	Philosophical Foundations, Operational Principles and Goals	Week 6	Assignment 2
6	The Role of al-Hisba in Regulating the economy	Week 7	Assignment 3
		Week 8	Assignment 4
<b>Module 3: THREE: INTRODUCTION TO MICRO AND MACRO ECONOMICS ANALYSIS</b>			
7	Consumer and Producer behaviours	Week 9	Assignment 1

8	Market mechanism from Islamic perspective	Week 10	Assignment 2
9	Aggregate demand and Supply, Fiscal and Monetary Policies	Week 11	Assignment 3
<b>INTRODUCTION TO ISLAMIC WELFARE</b>			
10	Appraisal Of Conventional Welfare Theory iii. Concept of Welfare iv. Critique of Conventional Welfare Theory		
11	Distribution In Islamic Economics iii. Goals of Distribution In Islamic Economics iv. Functional Distribution in Islamic Economics		
12	Redistribution in Islamic Economic s iv. Zakat v. Waqf Sadaqah, Inheritance, Gift		
	Examination	Week 13, 14 & 15	

### **How To Get The Most From This Course**

As you prepare to study this course, you need to realise the advantage of distance learning as availability of reading materials, studying at one`s pace and opportunity to study while working at respective locations. The study units replaces lecturer in distance learning. You read the materials instead of listening to the lecturer. It tells you when to read your books and other materials, when to embark on group discussions and when to conduct an exercise or assignment.

Each of the study units follows a common format. The first item is an introduction to the subject matter of the unit and how a particular unit is integrated with the other units and the course as a whole. Next is a set of learning objectives. These objectives let you know what you should be able to do by the time you have completed the unit.

Candidate should use these objectives to guide his study. When you have finished the unit you must go back and check whether you have achieved the objectives. If you make a habit of doing this you will significantly improve your chances of passing the course and getting the best grade.

The main body of the unit guides you through the required reading from other sources. This will usually be either from your set books or from a readings section. You will be directed when you need to embark on discussion and guided through the tasks you must do.

The purpose of the economic analysis of some certain economic issues are in twofold. First, it will enhance your understanding of the material in the unit. Second, it will give you practical experience and skills to evaluate economic arguments, and understand the roles of economic thought and approaches in guiding current economic policies and debates outside your studies. In any event, most of the critical thinking skills you will develop during the study of the materials are applicable in normal working practice, so it is important that you encounter them during your studies.

Self-assessments are interspersed throughout the units, and answers are given at the ends of the units. Working through these tests will help you to achieve the objectives of the unit and prepare you for the assignments and the examination. You should do each self-assessment exercises as you come to it in the study unit.

The following is a practical strategy for working through the course. If you run into any trouble, consult your tutor. Remember that your tutor's job is to help you. When you need help, don't hesitate to call and ask your tutor to provide it.

1. Read this Course Guide thoroughly.
2. Organize a study schedule. Refer to the 'Course overview' for more details. Note the time you are expected to spend on each unit and how the assignments relate to the units. Important information, e.g. details of your tutorials, and the date of the first day of the semester is available from study centre. You need to gather together all this information in one place, such as your dairy or a wall calendar. Whatever method you

- choose to use, you should decide on and write in your own dates for working breach unit.
3. Once you have created your own study schedule, do everything you can to stick to it. The major reason that students fail is that they get behind with their course work. If you get into difficulties with your schedule, please let your tutor know before it is too late for help.
  4. Turn to Unit 1 and read the introduction and the objectives for the unit.
  5. Assemble the study materials. Information about what you need for a unit is given in the 'Overview' at the beginning of each unit. You will also need both the study unit you are working on and one of your set books on your desk at the same time.
  6. Work through the unit. The content of the unit itself has been arranged to provide a sequence for you to follow. As you work through the unit you will be instructed to read sections from your set books or other articles. Use the unit to guide your reading.
  7. Up-to-date course information will be continuously delivered to you at the study centre.
  8. Work before the relevant due date (about 4 weeks before due dates), get the Assignment File for the next required assignment. Keep in mind that you will learn a lot by doing the assignments carefully. They have been designed to help you meet the objectives of the course and, therefore, will help you pass the exam. Submit all assignments no later than the due date.
  9. Review the objectives for each study unit to confirm that you have achieved them. If you feel unsure about any of the objectives, review the study material or consult your tutor.
  10. When you are confident that you have achieved a unit's objectives, you can then start on the next unit. Proceed unit by unit through the course and try to pace your study so that you keep yourself on schedule.
  11. When you have submitted an assignment to your tutor for marking do not wait for it return before starting on the next units. Keep to your schedule. When the assignment is returned, pay particular attention to your tutor's comments, both on the tutor-marked assignment form and also written on the assignment. Consult your tutor as soon as possible if you have any questions or problems.
  12. After completing the last unit, review the course and prepare yourself for the final examination. Check that you have achieved the unit objectives (listed at the beginning of each unit) and the course objectives (listed in this Course Guide).

## **Tutors and Tutorials**

There are some hours of tutorials (2-hours sessions) provided in support of this course. You will be notified of the dates, times and location of these tutorials. Together with the name and phone number of your tutor, as soon as you are allocated a tutorial group.

Your tutor will mark and comment on your assignments, keep a close watch on your progress and on any difficulties you might encounter, and provide assistance to you during the course. You must mail your tutor-marked assignments to your tutor well before the due date (at least two working days are required). They will be marked by your tutor and returned to you as soon as possible.

Do not hesitate to contact your tutor by telephone, e-mail, or discussion board if you need help. The following might be circumstances in which you would find help necessary. Contact your tutor if.

- You do not understand any part of the study units or the assigned readings
- You have difficulty with the self-assessment exercises
- You have a question or problem with an assignment, with your tutor's comments on an assignment or with the grading of an assignment.

You should try your best to attend the tutorials. This is the only chance to have face to face contact with your tutor and to ask questions which are answered instantly. You can raise any problem encountered in the course of your study. To gain the maximum benefit from course tutorials, prepare a question list before attending them. You will learn a lot from participating in discussions actively.

## **Summary**

The course Introduction to Islamic Economics (ECO731) exposes you to the fundamental principles of Islamic economics and finance. It provides Islamic world view as a Tauhidic paradigm which recognises the role of religion and divine sources of knowledge in addition to empirical and logical reasoning in economic matters. The course also exposes you to Islamic economic system which is devoid of interest and with some additional features such as justice and benevolence, accountable to Allah and fellow human being, responsibility and cooperation among the people. These are unique qualities that make the system to survive for over centuries despite the internal and external challenges it faces. More so, theoretically, you will learn the methodology it adopted in conducting empirical investigation on any subject matter of economics. In addition, topics like consumer and producer behaviours, markets, role of hisba, Islamic redistributive schemes are sufficiently discussed in the course. You will also learn some of the Islamic financial contracts that are used in Islamic banks. On successful completion of the course, you would have developed critical thinking skills with the material necessary for efficient and effective discussion on Islamic economics as a discipline and as a system. You will begin to appreciate the features of Islamic economics and finance as resilient,



sustainable and comprehensive in its approach. It will expose you to the economic role of religion in addressing what the fundamental questions of economics.

Yet, Islamic economics could best be understood if it is applied. You should also try to apply the principles in your term papers and other assignments so as to gain the best out of the course. We hope you will find the course enjoyable and fascinating.

## **MODULE ONE: OVERVIEW OF ISLAMICS ECONOMICS AND FINANCE**

**UNIT 1:Development of Islamic economics and its rationales**

**UNIT 2:World views and the role of religion in economics**

**UNIT 3: Methodology, Sources of sharia**

### **UNIT 1:DEVELOPMENT OF ISLAMIC ECONOMICS AND ITS RATIONALES**

#### **CONTENTS**

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  - 3.2 Historical evolution of Islamic Economics
  - 3.3 Rationales for the development of Islamic economics and finance
  - 3.4 Prohibited elements in Islamic Economics and Finance
  - 3.5 Selected Contracts in Islamic Finance
- 4.0 Conclusion
- 5.0 Summary
- 1.0 Tutor-Marked Assignment
- 7.0 References/Further Readings

#### **1.0 INTRODUCTION**

At this level, we are all conversant with the mainstream economic system such as capitalism and socialism. However, there is growing realisation of Islamic economics as a discipline and a system in the academics and industry respectively. The manifestation of which is found in the remarkable growth and

spread of Islamic financial institutions across the globe. The leading financial institutions have all embraced it and are, by day making adjustments to accommodate further its features and peculiarities. The World Bank (2016) describes Islamic finance as *“equity based, asset-backed, ethical, sustainable, environmentally and socially responsible-finance. It promotes risk sharing, connects the financial sector with the real economy and emphasizes financial inclusion and social welfare”*

This and many other qualities make the teaching and learning of Islamic economics and finance visible even in the western Universities such as Durham University, Harvard University among others.

## **2.0 OBJECTIVES**

At the end of this unit, student should be able to:

- Describe Islamic Economics, its nature and scope
- Discuss Development of Islamic economics and its rationales
- Discuss the rationales for the prohibition on interest, gharar and maysir.
- Describe major Islamic finance contracts

## **3.0 MAIN CONTENT**

### **3.1 The Meaning of Islamic Economics, Nature and Scope**

Before going into the definition of Islamic economics, it should be understood that Islam is a complete way of life devised by Allah the Almighty for the human beings. Literally it means submission; while technically, it refers to organizing the individual and social life according to the will of Allah. It is not only a compendium of moral and spiritual teachings but a full-fledged social system (al Deen) for all people and all ages. The edifice of Islam is erected on the foundation of faith (Iman) with 6 fundamental beliefs - Unity of Allah, Prophet hood, Angels, Books, Resurrection and destiny.

Defining economics is always a problem and sometime incomplete. It was established by Furqani (2014) that the consensus for a specific definition of economics is attained through a gradual process of knowledge accumulation by means of a creative interplay between a progressive conceptualization and the corresponding empirical and rational verifications (Bakar, 2010, p. 429). Lionel Robbins (1945, p. 16) defines economics as “the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses.” This definition though widely accepted, it leaves gaps in the real subject matter because it assumes static view of the material world rather than a dynamic description of the production process in relation with consumption, demand and supply. Samuelson (YEAR) defines it “as the study of how people and society choose to employ scarce resources that could have alternative uses in order to produce various commodities and to distribute them for consumption, now or in future, among various persons and groups in society.” Islamic economists have provided a number of definitions which clarifies the nature, subject matter, scope and approach of Islamic economics. Prof. Yousri (YEAR) observes that the definition offered by Samuelson is silent about welfare. He therefore proposes the definition of Islamic economics “as a science that studies the best possible use of all the available resources, endowed by Allah, for the production of maximum possible output of Halal goods and services that are needed for the community, now or in future, and the just distribution of this output within the framework of Shariah and its intent.” Yet, this definition is rather lengthy and repetitive. Another definition given by Chapra (1996) is that “Islamic economics is a branch of knowledge which helps realise human well being through an allocation and distribution of scarce resources that is in conformity with Islamic teachings without unduly curbing individual freedom or creating continued macroeconomic or ecological imbalances.”

Thus, in the light of this, Aslam Haneef defines Islamic economics as an “approach to, and process of, interpreting and solving man’s economic problems based on the values, norms, laws and institutions found in, and derived from the sources of Islam.”

Hasan (2015, p. 4): Islamic economics is the subject that studies human behavior in relation to multiplicity of wants and scarcity of resources with

alternative uses so as to maximize *falah* that is the wellbeing both in the present world and in the hereafter. According to Aliyu (2019) “Islamic economics is a social science that studies human behaviour in relation to acquiring, distribution and utilization of resources for the fulfilment of human needs based on the guidelines of the sharia.” The definition focuses on the behaviour of an agent with regard to the sources of wealth, spending and proper utilization of resources. Meanwhile, the conventional economics has scarcity and choice at its centre. This is different from Islamic economics which emphasises fulfilment of needs within a restrained boundary. Thought, Islamic economics recognises the existence of relative scarcity (not absolute scarcity) in relation to human wants, the choices to be made has to be in line with the provision of the sharia such as consumption of halal products and services.

Furqani classifies the over 20 available definitions of Islamic economics into four types which are as follows:

Type 1: Islamic economics as *the study of the principles and rules of sharī’ah* that make up the framework or milieu for an economic system, as well as activities and behaviour of economic agents;

Type 2: Islamic economics as the study of ways to realize *Islamic objectives in economics*;

Type 3: Islamic economics as the study of ways to solve *economic problems in the Islamic framework*; and

Type 4: Islamic economics as the study of *human (Islamic man) behaviour* in making choices and decisions.

### **3.1.2 Nature**

Economics as discipline deals with production, consumption and distribution of goods and services. Due to scarcity, there is the need to make choices. However, unlike in conventional economics, the decision on what to choose has to be “ethical”, “good” and “correct” choices. Man interacts with other human beings and nature to make these choices. Man cannot, in the process of fulfilling his self fish interest, infringe other peoples’ rights or involve in unethical practices that are tantamount to harming the society. In other words,

how man interacts is determined both by natural laws and social laws/culture in a system i.e. economic and financial system. Social laws/cultures are based on the worldview of a people while systems are products of society based on their worldview. Thus, Islamic economic system is based on the Worldview of Islam.

### **3.1.3 Scope of Islamic Economics**

The scope of the discipline is in three ways different from conventional economics. Firstly in terms of aims, unlike conventional economics which aims to maximize material benefit using limited resources, Islamic economics aims to maximise *falah* (success) with available resources i.e. trying to achieve success in this world and hereafter. According to Robinson (1934), economics studies human behaviour in making choice in a scarcity situation in a value free-sphere where ends are to maximize utility. In this regard, the selfish interest is key element in the subject matter. However, Islamic economics, according to Chapra (1996, p. 35), addresses economic problems from the point of view of goal realization whereby it studies all the factors that affect the realization of goals through their impact on the allocation and distribution of resources along with the values and institutions (social, economic and political) that influence human behaviour (Furqani, 2014).

Thus, Islamic economics emphasises social, spiritual, moral aspects of life not only utility maximization. Concern for others (altruism) is fundamental feature of Islamic economics. The objective of Islamic economics is to achieve the pleasure of Allah while fulfilling human needs.

Secondly, Islamic economics distinguishes itself from conventional economics in terms of approach of study. Islamic economics that is based on Islamic principles; the subject-matter will be studied in the light of Islamic injunctions utilizing methodology based on legitimate sources of knowledge in Islamic epistemology. Sources of economic knowledge are derived from the Quran, the sunnah, the logical and sound reasoning as well as experimentations. Economic theory integrates Islamic principles and empirical evidences. A theory is

considered sound and reliable if it is in conformity with Islamic normative principles, logically valid and empirically proven.

Thirdly, economists debated on the scope of their discipline. To some scholars such as Robinson is the science of scarcity and choice, while to Adam Smith is the study of wealth. Yet, according to Marshall is the study of material welfare in relation to human being. Wealth here represents the material means of satisfying human wants and consequently of promoting human welfare.

In Islamic economics, there are three groups that define the scope of Islamic economics. The first group of scholars maintain the basic condition of scarce-means and ends as given by Robinson but the mechanism to achieve the ends and solve economic problems follow the guidelines of the sharia. According to Mannan (1986) the scope of Islamic economics seems to become the administration of scarce resources in human society in the light ethical conception of Islam.

The second group tends to limit the scope to the study of Islamic man's behaviour in making choices and decisions. Scholars like Metwally (1983), Naqvi (1994) and Arif (1985) belong to this group. However, since the discipline can be adopted by all, the scope is actually beyond Islamic man. In fact, whoever exhibits good qualities as contain in the subject matter of Islamic economics can be considered as an economic agent who operationalizes the concept in practice. Observance of good ethical conducts, caring for others, sacrifice and cooperation are but universal qualities obtainable in Islamic economics.

The third group defines the scope of the study according to the objectives the discipline wants to achieve i.e falah (success). Falah means success in this world hereafter. The intent is to realise the comprehensive aspects of human development and achieve a high quality of life and happiness in this world and hereafter.

### **Self Assessment Exercise**

Define Islamic economics and explain its nature and scope.

## **3.2 Development of Islamic Economics and Its Rationales**

### **3.2.1 Evolution of Islamic Economics and Contributions of Muslims Scholars**

Islahi (2014) categorises the evolution of Islamic economics thought into six phases as presented below:

#### **The First Phase (1st Century of Islam/7th Century CE):**

This is formation period where by for almost century Muslims relied on their sources for dealing with socio-economic problems and the use of maslaha(public interest). At that time there was no pressing need to look outside the Quran and Sunnah. The economic teachings found in the Quran and Sunnah was expanded by Muslim scholars using Qiyas (The principle of analogy applied in the interpretation of points of Islamic law not clearly covered in the Koran or sunna-analogical inference or deduction) and Ijtihad ("process of legal reasoning and hermeneutics through which the jurist-mujtahid derives or rationalizes law on the basis of the Qur'an and the Sunna"). Key economic ideas include the work of Abu Yusuf (d.798) and al-Shaybani (d.805) who authored Kitab al-kharaj and Kitab al-kasab respectively; Ibn Abi al-Dunya (d. 891) on Islah al mal (betterment of wealth); Al-Mawardi (d 1058) on good governance and al-Ghazali (d.1111) on nature and functions of money. This period coincided with the baseless Schumpeterian Great Gap of 500 years of intellectual stagnancy that was repelled by many scholars even in the west.

#### **The Second Phase (Eight-Eleventh Centuries):**

This can be called translation period. Greek and Persian heritage translation into Arabic language started in the early eight century. This gives the scholars opportunity to learn and assimilate Greek and Persian economic ideas and improve upon them. Some of the key concepts that were analyse by scholars at that time include wants, satisfaction, economy of self sufficient household, division of labour, barter and money.

#### **The Third Phase (Twelfth-Fifteenth Centuries):**

This is retranslation period where Greco-Arab Islamic ideas were translated to Latin and other European languages (Durant 1950) Knowles (1963) wrote: "Beside acting as agents in the long process of transmitting Aristotelian thought from Syrian and

Persian through Egypt to Spain, the Arabian thinkers handed over a legacy of their own to the Latins”;

#### **The Fourth Phase (Sixteenth-Eighteenth Centuries):**

This may be called dormant phase which continued for almost three centuries. Thus 15th Century was peak of Muslim intellectual scholarship that produced the like of Ibn Khaldun (d1406). Ibn Khaldun introduced the cause and effect to study history on the fall and rise of civilization in his Muqaddimah, which he attributed to welfare or misery of people. He contributed in stages of development from rural to city state and nations. The period was also characterised by repetition, moral and intellectual stagnancy. Mercantilism and western power began to rise in high voltage. It took over the torch of sciences and kept it burning with greater brightness. This way, Muslim thinkers have influence on the scholastic economist in the West. For example, Ibn Taimiyah (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).

Thus, Ibn Taimiyah discussed the concept of just price, market mechanism and prescribed a price regulation policy for the state. In the 18th C. decaying forces in the great Muslim civilization speeded up and western colonization of Muslims land began. This coincided with some sort of awakening, soul searching and efforts at renovation by Islamic thinkers. Three great scholars in different parts of the world emerged- Shah Wali-Allah, (d. 1762) in the Indian subcontinent, Ibn Abd al Wahab (d.1792) In the Arabian Peninsula and Uthman bin Fodio (d.1817) in West Africa. For Ibn Fodio, his practical demonstration of economic ideas was visible: fair price, market mechanism, price control, muhtasib's economic functions, zakat and waqf, the role of government in economic life.

#### **Fifth Phase (Nineteenth & Early Twentieth Century):**

This can be called awakening phase. Political circumstances provided new opportunity of convergence which culminated into the re-birth of Islamic Economics; Muhammad Abduh (d.1905), Tahtawi (d. 1873), were concern about



socio-economic conditions of their peoples. During the 19th Century the Arab masses and people from Indian subcontinent got first exposure to European thought and modes of practice which opened their eyes. It was characterised by Intellectual awakening. Economic awakening - value of science and technology was recognized as key for commerce, agriculture and industrial development.

Advocating for value-based economic upliftment was top agenda;

Tahtawi (1912) discussed about productive and unproductive labour, foreign trade, competition. Abduh addressed poverty, abolition of bonded labour, lack of effective demand among others. Al-Kawakibi (1970), in his work Umm al-Qura, he observes that “If Muslims live really as Muslims; they will be safe from poverty. They will live an organized, common sharing way of life, the kind of which is desired by most civilised countries of Europe but who still do not know how to achieve it.”

#### **Sixth Phase (20th Century):**

The modern development of Islamic Economics is the sixth phase. It witnessed the 3 types of awakening above and adds with struggle between capitalism and socialism. Thus, Muslim economist found middle ground between 2 extremes. The desire to live according to Islamic code of life is imperative;

The first complete writing on Islamic Economics appeared in 1939 by Seoharwi on Economic System of Islam (in Urdu);

Few names in the Arab world who wrote on Islamic Economics: Rashid Rid (1901) wrote on zakah and financial difficulty, and interest; Ali (1939) on al-Hisbah; in the non-Arab world, Aghnides (1916) did his PhD on Mohammedan Theory of Public Finance; Ahmad (1924) on principles of wealth distribution and Islam. Kuran (2004) noticed only Qutb in the Arab world. In his book, Seoharwi stated that Islamic system consist of all virtues of other systems avoid their shortcomings. He asserts that it is a blessing not only for Muslims but the entire humanity. Islamic Economic is a product of intellectuals not only a single individual. It was a product of existing socio-economic and intellectual environment in early 20th century. Rodney Wilson, UK based Islamic finance expert remarked on the intention of the opponents of Islamic economics and finance. According to him “The main impediments to the growth of Islamic banking in North Africa have been political, as it has been wrongly

associated with Islamist political parties, notably the Muslim brotherhood.”

### **3.2.1 Contemporary Development**

There was increasing dissatisfaction with the western economic models theoretically and practically in the Muslim lands especially after independence. Theoretically speaking, Yasin and Khan, (2018, p.9) observe that “Despite the grand theoretical manifestations, rigorous mathematical modelling and empirical innovations with latest computer programming, modern economic analysis has failed to solve the critical problems faced by human beings in different societies.”

Islamic Economics enjoys the attention of Integration of Knowledge project that started in 1981 by the International Institute of Islamic Thought (IIIT) in the United States, and has developed more than many other disciplines. The unprecedented development coincides with the economic problems and educational crisis in the Muslim world after independence of many countries especially in the Middle-east and South-East Asia. According to Kamali (2013) the dominance of the western culture, systems and civilization in Muslims countries in the mid of the 20<sup>th</sup> Century led to massive and broad range of secularization and westernization of Muslim mind, culture, education, politics, economics and law. These perceived problems led to the search for lasting solutions within the context of Islamic belief; the results were series of meetings and consultations, till 1976 when the First Conference on Islamic Economics was held in Makkah. The outcomes of the conference were emergence of Universities and other learning and research institutions with a tilting interest towards integration of knowledge, establishment of many Islamic financial institutions in both Muslims and non-Muslim countries, especially Islamic banks; emergence of experts in Islamic economics and finance; and inclusion of Islamic economics components in many universities including Nigeria (Muhammad and Abdullahi, 2016). Currently there exists many universities around the globe that offer Bachelor and Masters Degree programmes in Economics with full or partial specialization in Islamic Economics.

Haneef, Yusof and Amin (2011) examine the quest for Islamic economics for Universities in the Muslim world, the case of International Islamic University Malaysia. Their work presents a model of an integrated curriculum structure that fulfills the Islamic objectives of higher education while ensuring the various needs of the market are met. The authors also investigated the relationship between values/character of graduates and work performance. Their findings reveal that there is no conflict between market demands and values. In addition, it was discovered that performance was highly dependent on character. The implication of this is that, apart from technical knowledge taught to students, values were equally, if not more, important to excel and perform well in a career (Muhammad and Abdullahi, 2016). The findings also suggest the need for inclusion of more ethical courses in the curricula of Nigerian universities (Daud and Muhammad, 2019).

### **Self Assessment Exercise**

Discuss the historical development of Islamic economics as a discipline.

### **3.3 Rationales for the Prohibition on Interest, Gharar and Maysir**

#### **Riba (Interest)**

Riba is one of the major prohibited elements in Islamic financial transactions. Riba, literally means an increase or growth. Technically refers to an increase which, in a loan transaction (riba al-dayn) or in exchange of a commodity (riba al-buyu'), accrues to one contracting party without giving an equivalent counter-value ('iwad) in return to the other party. It is therefore an increase on loan over and above the initial capital or on an item that are similar in nature usually essential commodities. However, is not all increase that is prohibited but unjust one (Q2:188). There are two types of riba. Riba on loan which is also called riba al-Quran or riba al-Jahiliya because it was stated in the Quran and was practiced during Jahiliyya (pre-Islamic era) and 2. Riba in exchange or Riba al-Sunnah because it was mentioned in the sunnah/hadith.

#### **Rulings on Riba**

The general ruling about riba is that it is, undoubtedly prohibited from all sources of the sharia. The Quran prohibits people from dealing with interest in four phases. The first phase it when the verse in suratu Rum (39) was revealed cautioning the users of riba ‘That which you give as riba’ to increase people’s wealth increases not with God; but that which you give in charity...”

And in Surat al-Nisa’, 161 (Early Madinan) where Allah says ‘And for their taking interest even though it was forbidden for them and their wrongful appropriation of other’s property.....punishment.’ The remaining 2 verses that came at last stages are in Surat-al-Imran, 130-32 (After migration to Madina) ‘O Believers, take not riba, doubled and redoubled (ad’afam muda’afah), and fear God that you may prosper .....

Again in Surat-al-Baqarah, 275-281 where Allah says ‘Those who benefit from riba.....they say bai’ is like riba while God has permitted bai’ and prohibited riba’.....(no benefit from riba’, give it up, if people cannot pay....give it as sadaqah)’

In the Sunnah, the popular hadith that prohibits riba states that *“Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt- like for like, equal for equal and hand to hand; if the commodities differ, then you may sell as you wish provided that the exchange is hand to hand.*

This hadith has far reaching implications in our businesses even today. Firstly, it shows that for essential commodities we can only exchange when there is equality in quantity and also on the spot. However, item will require either equality conditions or spot conditions. Wheat for wheat requires both. Different currencies require spot condition.

### **The Rationale for the Prohibition of Interest**

Scholars have deliberated on the rationale and wisdom for the prohibition of riba. It should be noted that in sharia, some rulings we can know the wisdom while others due to human limited knowledge is difficult to determine. Riba is

among the major prohibitions whose rationales are visible and obvious. Siddiqi identifies six major rationales as

i. *Riba corrupts society.*

In surat-al-rum verse 37-41 Allah says “...Corruption does appear on land and sea because of (the evil) which men’s hands have done, that He may make them taste a part of that which they have done, in order that they may return. (30: 37-41). According to Pickchai, charging interest is one of those wrong behaviours embarked by the people to cause fasad (corruption) on earth.

ii. *Riba implies improper appropriation of other people’s property.*

Misappropriation of other peoples wealth. Charging riba causes misappropriation of other people’s wealth and therefore prohibited. In sura al-Nisa where Jews are admonished for ‘taking usury when they were forbidden it, and of their devouring people’s wealth by false pretenses’ (4: 161).

Khan and Mirakhor (1987) observed that ‘interest on money is regarded as representing an unjustified creation of instantaneous property rights: unjustified, because interest is a property right claimed outside the legitimate framework of recognized property rights; instantaneous, because as soon as the contract for lending upon interest is concluded, a right to the borrower’s property is created for the lender’. (cited in Siddiqi, 2015).

iii. *Riba’s ultimate effect is negative growth.*

Riba is subject to destruction [mahq] (2: 276) which means decrease. after decrease, a continuous process of diminishing. There might be seemingly growth in individual business dealing on interest but there would be negative growth to the social wealth. Even at individual level evidences suggest that interest being the cause for business failure in many countries as long time survival is very difficult. In addition to that, even if there is any material growth, in the face of Allah cannot be considered and will cause negative

repercussions. Sadaqah however such as zakat increases wealth materially and in terms of reward in the hereafter.

Riba causes negative growth in the economy.

*iv. Riba demeans and diminishes human personality.*

Quran 2:275 states “Those who swallow usury cannot rise up save as he arises whom the devil has prostrated by (his) touch. That is because they say: Trade is just like usury; whereas Allah permits trading and forbids usury.” According to Siddiqi (2015) this depicts the picture of ‘those who devour usury’ as well as states the reason why they got into that pitiable mood. That reason is their being trapped into a false economics that equates trade—the act of selling and buying - with the practice of charging interest. It also means not only in the hereafter but also in this world.

*v. Riba is unjust.*

Quran 2: 279 clearly states that taking an amount in excess of the principal would be unfair, unjust. The lender charges an amount over above the capital lent without reciprocity. The borrower who may borrow to satisfy his real needs has to now find the main capital to repay plus additional charges. This is amount to inhuman relations and high level of exploitation and injustice in transaction.

## **Gharar**

Gharar means uncertainty. There are two types of gharar-minor uncertainty (Gharar yasir) and major uncertainty (Gharar fahish). Sharia accommodates minor uncertainty and prohibits major uncertainty. Examples of major uncertainties are sale of fish in the water, sale of bird in the sky sale of undisclosed item among others. In the modern economic dealings, insurance is a typical example of gharar fashish. In this, the buyer of the policy is not aware of what he is buying and the seller is uncertain about what exactly he sales. There are no certainties if the event occurs such as vehicle being stolen or house burn by fire. So the premium, the price of insurance is paid for unknown event. This makes it invalid and prohibited by the sharia. However, in Islamic

finance, there is Takaful (Islamic insurance) which is similar to insurance but devoid of interest, gharar and other prohibited elements. It is based on mutual cooperation among the participants who donates certain amount to mitigate the risk of their businesses or properties.

There is difference between risk and gharar. Risk is part of the business while gharar is not part of it. Risk cannot be avoided while gharar can be avoided.

Third,

### **Gambling**

Gambling is betting or staking of value with a consciousness of risk and hope to gain from an outcome of a game, a contest or an uncertain event whose result may be determined by chance or accident or have an unexpected result by reason of the bettor's miscalculation (Encyclopedia Britannica).It is a situation whereby one party wins everything and the other party losses everything, unjustifiably.

### **3.4 Rationales for the Prohibition of Gharar and Maysir**

This is prohibited largely because of the high level of injustice involves and potential conflicts. More, so, sharia is meant to protect and promote five things vis –a-vis religion, life, intellect, progeny and wealth. If this is the case, sharia would not allow any situation whereby a person will lose his/her wealth or lifetime savings easily as in gambling or lose his wealth due to uncertainty as in the case of gharar.

### **Self Assessment Exercise**

Explain in details the rationales behind prohibition of interest, uncertainty and gambling in Islamic economics

### **3.5 Selected contracts in Islamic finance**

**Mudarabah:** A Mudarabah is a form of Investment partnership. Here, capital is provided by the investor (the Rab ul Mal) to another party (the Mudarib) in order to undertake a business or investment activity. Profits are then shared according to pre-arranged proportions but any loss on the investment is born

exclusively by the investor and the mudarib then loses the expected income share. The mudarib is the investment manager or entrepreneur in a mudarabah. It is this managers responsibility to invest the investor's money in a project or portfolio in exchange for a share of the profits. A mudarabah is essentially similar to a diversified pool of assets held in a conventional Discretionary Managed Investment Portfolio.

**Murabaha:** means purchase and resale. As opposed to lending money, the capital provider purchases the required asset or product (for which a loan would otherwise have been taken out) from a third party. The asset is then resold at a higher price to the capital user. By paying this higher price by instalments, the capital user effectively gets credit without paying interest.(Also see tawarruq the opposite of murabaha.).

**Musharaka:** This means profit and loss sharing. It's a partnership where the profits are shared in pre-arranged proportions and any losses are shared in proportion to each partners' capital or investment. In Musharakah, all the partners to the commercial undertaking contribute funds and have the right, but without the obligation, to exercise executive powers in that undertaking. It's a similar concept to a conventional partnership and the holding of voting stock in a limited company. Musharakah is regarded as the purest form of Islamic financing.

**Tawarruq:** When used in personal finance, a customer with a cash requirement buys something on credit on a deferred payment basis. That customer then immediately resells the item for cash to a third party. The customer thereby obtains cash without taking an interest-based loan. Tawarruq is the opposite of murabahah.

### **Self Assessment Exercise**

List and explain ten Islamic financial contracts

## **4.0 Conclusion**

Islamic economics is more comprehensive and all-encompassing than its conventional counterpart because it is both positive and normative in nature, it



is value-loaded, it focuses on man's welfare both here and hereafter, it goes beyond achieving material satisfactions to include spiritual purification and its upliftment in this world as well as its ultimate salvation in the next life. Because of its divine origin and affiliation, Islamic economics is perfect in all its approaches to problem solving and devoid of any human error. It has in-built mechanisms capable of controlling or removing economic hardship in the society.

### **5.0 Summary**

This unit discusses the meaning, nature and scope of Islamic economics which is defined as the study of human behaviors in relation to consumption, production, distribution and choices among alternative relatively scarce resources in accordance with the tenets of Islamic law or Shari'ah. The unit also discusses the historical development of Islamic economics which can be divided into five phases from its classical primitive nature to its present modern form. Also, the unit highlights the rationales behind prohibition of interest, uncertainty and gambling in business transactions on the ground of injustice, exploitation, disincentive to work and produce social vices etc. Lastly, the unit explained some Islamic financial contracts such as Mudarabah, Musharakah, Murabaha, etc. which serves as alternatives conventional interest-based finance.

### **6.0 TUTOR MARKED-ASSIGNMENTS**

- (1) What is Islamic economics?
- (2) Discuss the historical development of Islamic economics as a discipline
- (3) Explain in details the rationales behind prohibitions of interest, uncertainty and gambling in business transactions.

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## **UNIT 2: World views and the role of religion in economics**

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- 1.0 Introduction
- 2.0 Objectives
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  - Definition of World View
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### **1.0 Introduction**

Worldview is the perception of a person regarding the world and other creations. A worldview is the ultimate foundation of all human conduct, including scientific, philosophical and technological activities.

No Human Endeavour is value free; thus the need for Islamic worldview. Since alternative worldviews/ideologies exist, different economics are not only possible but, one can argue that it is natural and legitimate as well. In fact, as argued by Heilbroner (1988) without a vision or a “belief system” there can be no economic analysis because there will be nothing to analyse.

The Quran says “Men who celebrate the praises of Allah standing, sitting, and lying down on their sides, and contemplate the wonders of creation in the heavens and the earth, (with the thought): "Our Lord! Not for naught Hast thou created all this! Glory to Thee! Give us salvation from the penalty of the Fire” (Qur’an 3: 191).

This verse provides fundamental principle of governance where everything created by Allah has a purpose and human being is created to be the world’s vicegerent. By putting a trust to mankind as a vicegerent, Allah plays actively roles to monitor and involve in every affairs of human being and He is aware

and knowing everything all the times (Chapra, 1992: 202).

Islahi (2018) state that Islamic literature does not capture worldview as used in contemporary studies; in the contemporary period, Jamal el din Afghani (d.1987), Muhammad Abduh (d. 1905) and Rashid Rida (d. 1935) discussed some aspects and insights about worldview. However, Sayid Qutb (d.1966) provides the first systematic work on the Islamic worldview as he focuses on ideological content and teaching of the Islamic worldview.

A worldview is formed through culture, technology, scientific, religious and speculative ideas that we acquire through education and other means or through conscious effort to acquire knowledge or both;

According to Syed Al Attas (1978) worldview is “an architectonic network of ideas, conceptions, beliefs and aspirations in which all that make it up are organized in a coherent manner, but not necessarily in a systematically interconnected network. A worldview therefore is that vision of reality and truth, which, as an architectonic mental unity, acts as the non-observable foundation of all human conduct.

## **2.0 Objectives**

At the end of this unit, students are expected to understand:

- Definition of World View
- Types of Worldview
- Dimensions of Islamic Worldview
- Economic Implications of Islamic Worldview

## **3.0 Main content**

### **Types of Worldview**

With regard to the type, generally there is Revealed Worldview and there is Man-made Worldview. Under the Revealed Worldview, there are preserved and not preserved worldviews (for instance Judaic worldview).

Under the Man-Made Worldview, there is ethical/religious (The religious world view is under the revealed world view. What should be under man made worldview is for example-enlightenment world view), oriented (Buddhism) scientific and philosophical worldviews. Scientific worldviews built on scientism claims that

science is the only way of knowing reality.

According to scientism, “if something is not rational, or not verifiable through the physical senses, then it is not real.” McFarlane (1999). Hence empirical observation, experimentation, rationalism and scientific scepticism are the principles of scientific worldviews.

However, McFarlane (1999) candidly stated that “Most of us are sophisticated enough to know that science never provides us with the final theory of reality, and that our ideas about the world can be mistaken sometimes. But we normally attribute those errors to minor problems with our theory, and believe that our theories are getting closer and closer to truth.” The partial presentation or reductionist approach to reality calls for recognition of scientific limitations.

Since factors affecting world views differ, different world views exist, leading to different “systems” for different peoples, Theories explaining human behaviour also differ;

Islamic world view is based on ‘Islam’ and its sources of knowledge. This worldview is complete at the time of revelation of the Qur’an, implying that fundamental concepts in the Qur’an are not open for changes in meaning;

All worldviews must at least include views on God, nature, man, religion, knowledge, and aim in life, among others.

### **Self Assessment Exercise**

Differentiates between Islamic worldview and western worldviews

### **The Role of Religion in the West**

According to Watts (1979), religion means “... a way of spending an hour or so on Sundays in practices which give him some support and strength in dealing with the problems of daily life, and which encourages him to be friendly towards other persons and to maintain the standards of sexual propriety; it has little or nothing to do with commerce or economics or politics or industrial relationships...” or may even look on religion as an opiate developed by exploiters of the common people in order to keep them in subjection.

In the West, religion is reduced to a private matter between an individual and his/her God(s). No role to play in determining public affairs of man. Similarly, Science replaced religion as authority. Religion is for infantile man; science is for modern/nature man; Nietzsche Fredrick, a French philosopher who lived

between 1844-1900 proclaims that “God is Dead”;

This understanding of religion is not necessarily applicable to all societies and civilizations. Koopmans (1969) has rightly observed, when he said: “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 judgements and good governance in the efficient and equitable allocation and distribution of resources, in practice this did not take place fully. Eliade in *Encyclopaedia of Religions* (1987), states: “...this dichotomy between the religious and the remainder of human life is a western product and concern...” This distinction between the sacred and the profane, between religion and other aspects of human endeavor is a result of the process of secularization that has been the experience of Christian/Western civilization especially since the 17th century.”

To understand the position of religion in the west today and its implications for economics, both the discipline and activity, we have to differentiate between three terms-secular; secularization; and secularism.

**Secular:** From the Latin word “saculum”, denoting space and time, i.e. here and now. Secular activities are activities that deal with the here and now. Usually this is taken to mean activities for this world and in our life. Islamic view of religion is not ‘anti this world’. In fact, Islam has very clear guidelines on how to undertake life in this world, including economics.

**Secularism:** Ideology that says only this world is relevant; when combined with materialism, it also denotes that only this world is real. Hence, any reference to the ‘hereafter’ is irrelevant. Economics should be conducted purely on ‘costs and benefits’ that are of this world. Islam would not be able to accept this ideology.

**Secularization:** Secularization is seen as a process that saw the gradual decline of religion and its authority over life, as occurred in western civilization in the age of enlightenment as elaborated by Cox (1965) and Al-Attas (1978). It’s

made up of three components:

- i) Disenchantment of nature (dissatisfaction with what nature provides)
- ii) Desacralization of politics (separation between religion and state)
- iii) Deconsecration of values (flexibility of all values)

While Islam has no problem with involvement of man in secular pursuits, secularism, the ideology and secularization as a philosophical programme/process, is incompatible with Islam and its worldview;

### **The Role of Din al-Islam in life**

The word Din is much deeper in meaning than religion as understood in the west. According to Watt (1979), Islam is a "...whole way of life ... covers both the private and public/societal lives of man, it permeates the whole fabric of society, and includes theological dogma, forms of worship, political theory and a detailed code of conduct, including even matters which the European would classify as hygiene or etiquette..."Man should not shun this world entirely, unlike in other cultures or religion. Man should enjoy the bounties of Allah within the shariah constraints and guidelines.

The Din is for this world as well as hereafter. Man should use this world (Dunya) to achieve the hereafter (akhiraha). Allah says in the Qur'an, Surat Al-Qasas: 77, Allah states: "But seek with the (wealth) which Allah has bestowed on thee, the home of the Hereafter, and do not forget thy portion in this world. But do good as Allah has been good to thee and seek not mischief in the land, for Allah loves not those who do mischief."

The religion of Islam is the willing and conscious submission to God to 'pay back our debt' for our existence.

Economics and its related activities are potentially ibadah or acts of worship if intention, knowledge and action are determined, according to Shari'ah.

### **The Unity of God**

Islam teaches the concept of Tawhid or Unity of God. A Muslim becomes Muslim after a determined testimony of unity of Allah through Kalimah Shahadah (word of testimony). The beautiful names of God contained some

economic implications, viz: Al-Razzaq (the Provider), Malikal-Mulk (the eternal owner of Sovereignty), Al-Muqsit (the equitable) etc.

### **The Role of Man**

Al-Insan (Man) was created by Allah endowed with spiritual and physical components to enable him discharge his responsibilities, including economic functions. In Surat Al-Hijr, Allah states: “ Behold! Thy Lord said to the Angels, I am about to create man, from sounding clay from mud moulded into shape. When I have fashioned and breathed into him of my spirit, fall ye down in obeisance to him.”

He was given ‘aql (mind) and knowledge (ilmu). In Surat Al-Baqarah Verse 31, Allah states: And He taught Adam the names of all things...

Among God’s creations, mankind is the best of creations. In Surat Al-Tin Verse 4, Allah says: “We have indeed created man in the best of moulds.”

He was given the role of Abd (servant) and Khalifah (vice-gerent). In Surat Al-Dhariyat Verse 56, Allah states: “I have only created Jinn and Man that they may serve me.’

In Surat Al-Baqarah Verse 30, Allah says: Behold! Thy Lord, said to the angel and I will create a vicegerent on earth...To be a Khalifa one must be first and foremost an ‘Abd. Syed Nasir (1990) states that: “There is no more dangerous creature on earth than a khalifah of Allah who no longer considers himself to be an ‘abd Allah.”

### **The Concept of Nature**

Regarding the concept of Nature in Islam, Allah has created all other things for the benefits of Man. In Surat Al-An’am, Allah informs Man about: Vegetation and fruits, night and day, heavens and earth, human beings, rain, material world and world of ghayb (the unseen). Man as trustee to manage nature; nature as a sign of God.

### **The Purpose of Man`s Life on Earth**

The aims of man on earth include the following:

- i) Ibadah to achieve falah (ultimate success)



- ii) Develop earth to achieve God's pleasure

However, to achieve the above requires means as follows:

- i) Al-nafsiyyah – faith (iman), character
- ii) Al-jismiyyah - health, strength, long life
- iii) Al-kharijiyyah - wealth, influence, family
- iv) Al-tawfiqiyyah - divine grace

Thus, to attain falah (success in this world and hereafter) we must possess and blend knowledge with action.

### **The Concept of Knowledge**

The word Ilm and its derivatives appear 750 times in the Qur'an;

It is a fundamental requirement for all Muslims life-long. Its acquisition is obligation (fard). The sources of knowledge are:

- i) Revelation - primary source
- ii) Reason - secondary source
- iii) Universe - secondary source

In view of the above it can be stated that Islamic worldview is remarkably different from secular/conventional worldview in many respect.

### **4.0 Conclusion**

Man's endeavours in this world, weather economic, social or political are directly determined and controlled by his worldview. Those who view this world as their permanent home for eating, playing and sleeping, would probably waste all their time and energy pursuing its vain glory. Similarly those who view this world as a temporary testing place would constrain their activities within the boundaries and work towards passing all the tests of this life in order to achieve ultimate salvation in the next life. Thus, this marks the fundamental difference between western worldviews and Islamic worldviews.

### **5.0 Summary**

The unit discussed worldviews, its meaning and nature its different types and dimensions. The unit posits that worldviews generally is the perceptions of

human beings about the purpose of life in this world. The western or secular views of the world have limited horizon and foresights that didn't go beyond their noses. Hence, they take this world life as an end in itself not a means to an end as the Holy Qur'an clearly stated. In the other hand, Islamic worldview is more comprehensive in nature and all-encompassing in scope because it looks at this worldly life as temporal and a means to attain the ultimate goals of human existence which is achieving *falah* in the next life. The unit also discussed the economic implications of Islamic worldviews where it directs man to be just and God-conscious in all his endeavours in which economic pursuance is not an exception.

## **6.0 Tutor Marked-Assignments**

- (1) Define worldview and expatiates on its nature
- (2) List and explain different types of worldviews you know
- (3) Discuss the economic implications of Islamic worldview

## **7.0 References/Further readings**

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## **UNIT 3: METHODOLOGY AND SOURCES OF SHARIA**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Meaning of Sharia
  - 3.2 Sources of Sharia
  - 3.3 Epistemological Foundations
  - 3.4 Methodology of Islamic Economics
- 4.0 Conclusion
- 5.0 Summary
- 4.0 Tutor-Marked Assignment
- 7.0 References/Further Readings

### **1.0 INTRODUCTION**

Methodology is the less understood aspects of not only Islamic economics but also economics in general. Methodology is different from methods as methods entails following some guidelines to conduct a research. Methodology on the other hand refers to set of criteria and guideline of evaluating a particular discipline to ensure it is punctual and accurate. This section introduces Islamic economics methodology, its sources and approaches of model building in the discipline.

#### **1. Objectives**

- i) To expose students to meaning of methodology
- ii) To compare between Islamic economics methodology and western methodology
- iii) To enhance your understanding on the concept of shariah and its sources as methodological tools in Islamic economics
- iv) To demonstrate how to build a model in Islamic economics

### **3.0 Main Contents**

#### **3.1 Meaning of Sharia**

Shariah literally refers to a path to watering place. Technical meaning however, refers to a path to tread for guidance in this world, commands, prohibitions and values for human life. It is a means which Allah addressed to man for

achieving divine success. Shariah sometimes is used interchangeably with Islam but the later is broader while the former is more specific on what to do, how to do and when to do it. Allah says “we have put you on a path of things follow it and do not follow the paths of those who do not know.”Quran:

The Shariah is divided into five categories:

- i) Obligatory (Wajib) like prayer and fasting
- ii) Recommended (Mandub) like voluntary charities
- iii) Permissible (Mubah) like trade and business engagements
- iv) Reprehensible (Makruh) like hiding information
- v) Forbidden (Haram) like corruption

However, Shariah, needs interpretation and application and the product of this is called fiqh. Fiqh is the human effort and product of the human intellect. This effort follow certain rules and regulations, procedures and criteria i.e. usul al-fiqh. Usul-al-Fiqh is the knowledge of the principles and methods leading to the derivation of fiqh. Therefore, usul-al-fiqh requires ijti had-intellectual assertion- where basically methodology being discussed. Now, there are three types of ijti had, new cases, old cases and modified cases.

### **Self Assessment Exercise**

What do you understand by the concept of Shariah

### **3.2 Sources of Shariah**

There are primary and secondary sources of the Shariah. Primary sources consist of Quran and Sunnah. The secondary sources include analogy, consideration for public interest, juristic preference and presumption of continuity. According to Haneef (2013): “One thing that should be noted is that Islam has revealed sources (Quran and Sunnah) and non-revealed sources, such as analogical reasoning (qiyas), consideration of public interest (istislah), juristic preference (istihsan), presumption of continuity (istishab), and so forth. Whereas the revealed sources may have clear injunctions and command permanent validity, their interpretation via usul al-iqtisad and its non-revealed sources are not permanent, for they are mainly the product of an ijti had.”

### 3.3 Epistemological Foundations

Epistemology, the theory of knowledge aims to answer some existential question such as the existence of God, man and universe. It also seeks to address the question of what we know and how we know it. In conventional economics, the sources of knowledge are logical and empirical tests. In Islamic economics however, the sources are primarily the revealed knowledge and then derived. While the revealed sources are the Quran and sunnah, the derived one are the senses and reasons.

Epistemology tries to answer the question what we know and how do we know it. Islamic epistemology, unlike conventional economics does not rely on human rationality and senses as the only source of information. In fact, these channels of acquiring knowledge are secondary and subject to verification by Islamic revealed knowledge. With regard to the philosophy, Islamic economics is built on tauhidic paradigm i.e. unity of Allah, His creations and absolute control over all things. Allah says in the Quran *“And to Allāh belongs the dominion of the heavens and the earth, and Allāh has power over all things”* (Q:3:189). This view contradicts the conventional philosophy which perceives the universe as a coincidence that emanates from a big bang. It also perceives human being as originally an animal who evolves to rational being and self-centred that is reflected in his calculative mind before arriving at any economic decision. Rationalism, a particular epistemology that beliefs all knowledge is being of faculty reason rather than experience (Suharto, 2006). The approach is that science is the only source of knowledge and the rest are ‘pseudo knowledge’. This belief is spearheaded by positivists that considered science as the highest achievement of the mind and sought to apply a strict empirical approach to the study of nature and society. According to this epistemology, studying reality beyond the realm of experience is an exercise in futility (Suharto, 2006).

Epistemology should be understood within a certain worldview which would entail a certain theory of knowledge characterized by certain ways of

understanding sources from which we acquire knowledge of means and purpose of it (Malkawi, 2017).

Islamic worldview is distinctly different from conventional economics. It is a worldview that is submissive to Allah, the Creator of the universe, and the absolute owner of all resources. Thus, human being is a servant of Allah and a caliph of Allah on earth. He is responsible for manning the affairs of the world, accountable to Allah and fellow human beings. Whatever is given to him is a trust from Allah. Based on this world view, resources of the universe are to be extracted and utilised to satisfy needs of human beings and other creations without wastage. Contrarily, conventional economics worldview perceives the existence of resources as coincidence, and can be domesticated to achieve one personal interest with less attention on others.

### **Self Assessment Exercise**

Discuss the essential elements of epistemology from conventional and Islamic economics angles

### **3.4 Methodology of Islamic Economics**

Conventional economics has succeeded in seemingly following the path of scientific discipline. This starts from setting specific assumptions to making propositions, to hypothesis development and testing as well as acceptance or rejection of a phenomenon. The approach that follows scientific method such as observation, recording, analysing and reaching a conclusion has since being criticised for subjecting human being to rigorous testing as human is not predictable. Blaug (1993) defines methodology of economics as the branch of economics where we study how economists justify their theories, and the reasons they offer for preferring one theory over another.

Haneef (2013) states that, methodology analyses the process through which knowledge about economic phenomena is authenticated. Its scope goes beyond techniques and several procedures of conducting a research or theory appraisal. It involves the criteria, the justification, arguments for theory appraisal, testing and proving the reliability or otherwise of the theory. According to Haneef (2013) this meaning and understanding of methodology is not fully reflected in

most of the works of Islamic economics. He conducted a survey on theory appraisal in Islamic economics and the summary provided below:

According to Mannan (1989), the objective is to produce economic theory based on Islamic framework. This can be achieved by identifying economic issue, searching explicit and implicit guidelines in the sharia and formulate the theory. According to Chapra (1996) theory development could be accomplished by using methodological pluralism that scrutinises the economic hypothesis and evaluate based on sharia guidelines. This view is similar to Zarqa (2003) that proposes replacing preconceived values with Islamic values and adding Islamic descriptive statements.

Hasan (1998) however proposes a step by step approach by sifting, pruning, and modifying conventional economics theory to conform with sharia provisions. To him, rediscovering Islamic doctrines is the main objective which can adopt fiqh approach. Contrary to this view is that of Naqvi (1981) who advocates for systematic development of analytical framework of Islamic economic teachings that fits into a set of axioms from which economists can deduce policy relevance and make a conclusion. He proceeds to provide the 4-axioms as *unity, equilibrium, free will and responsibility*.

A more advanced framework is provided by Haneef (1997) who proposes developing Islamic economic theory based on its own framework and criteria. In this approach, there is the need to identify all verses and hadith related to economics, synthesis them into principles and postulates, incorporate contemporary knowledge of economics and finance and test the reliability of the theory against the set of criteria developed in Islamic framework and that of scientific method. One weakness in this approach as pointed out by Khan (2013) is the decision to accept seems to be biased as hardly any rejection is being made. It compares what is and what ought to be. If what is contradicts what ought to be still the hypothesis is maintain but suggestion would be made to change what is, to what is ought to be. Haneef (2013) also proposes the need for Usul al-Iqtisad on the methodology for behavioural sciences. This methodology would accommodate more interactions and views than restricted



fiqh view. It would deal with philosophy of the discipline, the rules and guidelines, the expected behaviour and measurement of these behaviours based on realities. It would accommodate naqliyyah (primary sources) aqliyyah-ijtihad- that would cover reasoning experimentation and observation.

### **Self Assessment Exercise**

Discuss the methodological issues in Islamic economics

### **4.0 Conclusions**

Islamic economics is sourced and derived from Shariah which is the Islamic laws and principles revealed in the Holy Qur'an and Ahadith of Prophet Muhammad (S.A.W.) guiding all human activities to be in accord with the Will of Allah (S.W.T.). Unlike conventional economics, Islamic economics' major terms of reference are in accordance and in compliance with the dictates of Shariah. Islamic economics' approaches to the solutions economic problems are fundamentally different from conventional one because it approach economic problem from two angles with two eyes open (i.e. it tries to solve man's economic problems both in this life and the next) while conventional economics only looks at this life and neglect the next.

### **5.0 Summary**

This unit discussed the meaning and sources of Shariah where it posits that Shariah is a divine way or guidance revealed by Allah (S.W.T.) to direct man towards attaining God pleasure in the next life. Holy Qur'an and Sunnah of Prophet Muhammad (S.A.W.) are primary sources of Shari'ah while human reasons that conform to the teachings of Qur'an forms the secondary sources of Shari'ah. The unit also discussed the epistemological foundations of Islamic economics which is the sources of knowledge and is different dimensions in Islamic economics. Lastly the unit discussed the methodological issues in Islamic economics and it differs from conventional once.

### **6.0 Tutor-Marked Assignment**

- (1) Define the term Shariah and show how relevant it is in Islamic economics

- (2) Discuss the epistemological foundations of Islamic economics
- (3) How methodologies of Islamic economics differ from conventional economics?

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## **MODULE TWO: ISLAMIC ECONOMIC SYSTEM**

UNIT 1 Features of Islamic Economic System and other Systems

UNIT 2 Philosophical Foundations, Operational Principles and Goals

UNIT 3 The Role of al-Hisba in Regulating the economy

### **UNIT ONE: Features of Islamic Economic System and Other Systems Content**

1.0 Introduction

2.0 Objectives

3.0 Main Content

3.0.1 Islamic Economic System

3.0.2 Features of Islamic economic system

3.0.3 Difference between Islamic economic system and other systems

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further readings

#### **1.0 Introduction**

Economic system, generally, is the way and manner through which the acquisition, utilization, management and disposal of economic resources are planned and structured based on predefined norms and principles of the society. Mankind has experimented, under the leadership of the West, with four major economic systems during the last three hundred years: capitalism, socialism, nationalist-fascism and the welfare state. All of them were based on the fundamentally and characteristically Western premise *that religion and morality are not relevant to the solution of man's economic problems, that economic affairs are better settled by reference to the laws of economic behaviour and not in respect of any social code of moral conduct*. This leads to the collapse of authoritarian and dictatorial fascist and socialist systems, and the recent continues economic crisis signal the ultimate demise of capitalist and so-called welfare state.

This unit discusses the salient distinctive features of Islamic economic system and shows, comparatively, how it differs from other economic systems.

## **2.0 Objectives**

At the end of this unit, students should be able to:

- Described what Islamic economic system is all about
- Understand the basic features of Islamic economic system
- Differentiate between Islamic economic system and other systems

## **3.0 Main Content**

### **3.1 Islamic Economic System**

Islamic economic system is an economic system is rooted in the tenets of Islam or Shari'ah. It is an architectural economic structure designed to fulfill the ultimate welfare needs of the society (both here and the hereafter) in accordance with the provisions of Islamic principles. According to Muhammad Yasin (2016) "Islam prescribes an economic system that makes it absolutely imperative to use the endowments of Allah for fulfilling the essential needs of the society and for providing the individuals with decent living conditions". Unlike socialism and capitalism, Islamic economic system is value loaded and based on what ought to be rather than what is. The figure below summarized the structure of Islamic economic system.

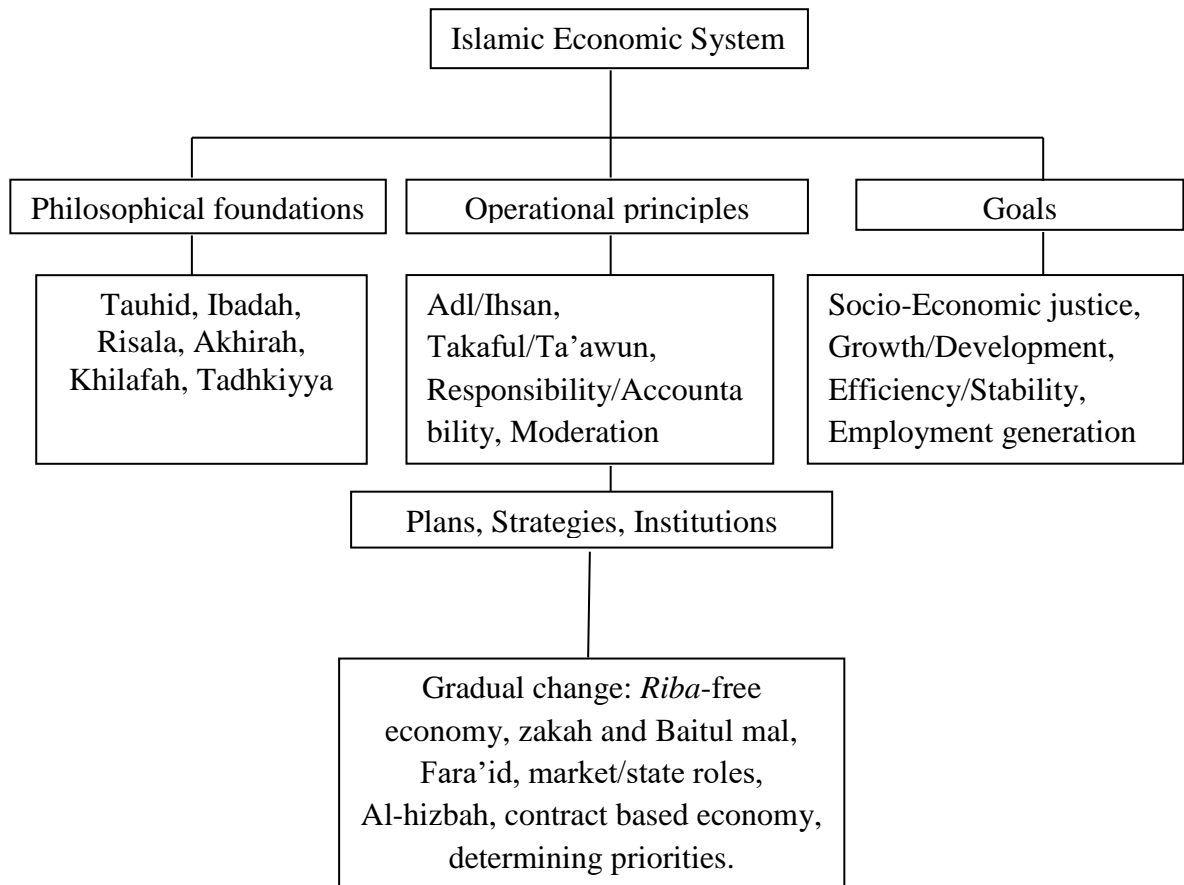


Figure 1. Islamic Economic system (Adapted from Islamic Economics lecture note prepared by Dr. D. M. Aliyu)

From the figure, it can be seen that the Islamic economic system is structured into three main categories; the philosophical foundations which include *Tauhid* (i.e. testifying in the heart the unity of Allah), *Ibadah* (i.e. Subjecting all human activities according to the dictates of Allah), *Risalah* (i.e. Message from Allah guiding all human activities), *Akhirah* (i.e. believe in the last day or judgment day where everyone will account for his actions), *Khilafah* (i.e. Man acting as a vicegerent of Allah on earth), *Tadhkiyya* (i.e. Purification of soul); Operational principles which include *Adl/Ihsan*, *Takaful/TA'awun*, Responsibility/Accountability, and moderation; goals which include; socioeconomic justice, growth and development, efficiency, stability, employment generation. Detail explanation these concepts will be in unit three.

## Self Assessment Exercise

Explain the nature of Islamic economic system

### 3.2 Basic Features of Islamic Economic System

#### (a) Ownership of resources

In any economic system, the key element of differentiation is the ownership of resources. Islam has a highly articulated concept of the rights and limits of ownership. Allah is the ultimate owner of all resources and man is only a trusty or vicegerent of Allah on earth who is entrusted with the resources as an *amanah* (trust) for a limited period of time. In this regard, man is expected to use the resources in accordance with the provisions of Shari'ah.

The wealth that we have today, in essence, belongs to God. We as humans are given the opportunity by God to make the best use of it. As stated in Surah Al Baqarah [2:284] "*Allah is the sole proprietor of everything in the heavens and on earth.*" Also, in Surah Al Hadid [57:7] that Allah also says that humans spend part of the wealth that God has given. The Prophet also said: "*This world is green and sweet. Allah has made you the caliph (ruler) in the world. Therefore, you should discuss how to rule the wealth in this world.*"

This characteristic distinguishes the concept of ownership in Islamic economic systems with capitalist and socialist economic systems. In Islam, individual ownership is highly respected, but not absolute. Its use must also not conflict with Islamic law. In capitalist system, ownership is absolute and free in any way to use it. In contrast to the socialist system, this system does not recognize individual ownership; the state has full authority over everything.

#### (b) *Shari'ah* as the guiding principles

Islamic economic system is based on the principles of *Shari'ah*. All economic activities must be carried out in line with the provisions of Islamic law. The law is comprehensive all-encompassing that left nothing untouched. The

Prophet (S.A.W.) said “the lawful and prohibited things are clear but in between them are ambiguous things.....” It is left to the man to seek knowledge and protect his religion from ambiguous things.

#### (c) Motivation

The major motivating force to participate in the production process in capitalist economy is to satisfy self-interest through accumulation of profit. But in Islamic economy altruism is highly encouraged. However, earning profit through lawful means is allowed but it should not be ultimate aim of a Muslim. Islam encourages man to strive and work hard for his livelihood and at the same time remains dutiful to his lord.

Also the leader must be just and treat everyone equal without fear or favour. This would make his subordinates to be just and fair among them.

#### (d) Decision making and state intervention

Islam authorizes the state to regulate its economy. This is done to fulfill the needs of the community. The state is obliged to protect the interests of the public from injustice both by the individuals and groups, institutions, or even other countries. The community's security to live well and properly is also a state obligation. The state should be able to fulfill basic needs in terms of food, education, and health of its population.

#### (e) *Zakat* or Compulsory

*Zakat* literally means purification, technically means purification of wealth by giving out 2.5% of the wealth if it reach twenty *Dinar* (Gold) or its equivalent. It is one of the economic characteristics of Islam that does not exist in other economic systems. The wealth that we have is essentially God's property, so we need to spend this treasure to provide for the Islamic cause. The purpose of *zakat* is to cleanse the soul of envy, misery, and revenge. From every property that we

have, not only must we pay taxes, but we are obligated to pay zakat if we reached its limit (*nishab*).

(f) Prohibition of Usury

Usury or interest is an addition or excess over and above principal amount in a loan transaction. It is vehemently condemned and prohibited in Islamic economy. Allah says in the holy Qur'an "*Those who benefit from interest shall be raised like those who have been driven to madness by the touch of the devil; this is because they say 'trade is like interest' while Allah has permitted trade and forbidden interest.* Hence, those who have received the admonition from their Lord and desist may have what have already passed, their case being entrusted to Allah; but those who revert shall be the inhabitants of the fire and abide there in forever". (2:275). Therefore Muslim must shun all forms of interest in their business transactions.

**Self Assessment Exercise**

Explain the distinguishing features of Islamic economic system.

**3.0.3 Difference between Islamic Economic System and other Systems**

Since we have seen the nature and basic features of Islamic economic system in the previous units, it is important to know the nature and some basic features of other economic systems before discussing their differences.

**Socialism:** The social and economic organization of the society where the means of production are owned and control by the community. Each member of the society contributes to the production of goods and services according to his ability and get according to his needs. Pioneered and championed by Marx, socialism postulates the doctrine of "class struggle" which is the consequences of "alienation of proletariats" by the bourgeoisies (capitalists) that owns the means of production and uses their power to exploits the proletariats (workers).



In socialist state, the decision regarding what, how and for whom to produce is taking by the central planning authority. Private ownership of the means of production is not allowed in the socialist system and market forces of demand and supply are irrelevant in determining prices. The system proposes revolution by the workers to overthrow the ruling class and ends their exploitative power and consequently the classless society would emerge where everyone work according to his ability and get according to his need. Although this argument sound good, but the system failed to provide way out of exploitative tendencies in the classless society because means of production cannot be manage by all the proletariats. The management of the society's economic resources must be delegated to few which would ultimately leads to the emergence of a very powerful class in form of central planning authority. Hence, the situation of the masses would be worse than that of the capitalist system.

**Capitalism:** This is the economic system that emphasized unrestricted freedom of individual economic unit to pursue his self-egotistic interest according to his test and desire. It prescribed private ownership of the means of production and allows the invisible market forces of demand and supply to determine prices and allocate resources efficiently.

Capitalism may be said to have the following five distinguishing features:

- (a) It considers accelerated wealth expansion and maximum production and 'want' satisfaction in accordance with individual preferences to be of primary importance in human well-being.
- (b) It deems unhindered individual freedom to pursue pecuniary self-interest and to own and manage private property to be necessary for individual initiative.
- (c) It assumes individual initiative along with decentralized decision-making in freely operating competitive markets to be sufficient conditions for realizing optimum efficiency in the allocation of resources.

(d) It does not recognize the necessity of a significant role for government or collective value judgments in either locative efficiency or distributive equity.

(e) It claims that serving of self-interest by all individuals will also automatically serve the collective social interest.

However, capitalism, in its classical laissez faire sense, does not and has never exist anywhere in the world because governments continue to intervene in the economy to stabilize and regulate economic activities. The great depression of 1930s brought the end of capitalism and marked the beginning of Keynesian economics.

The Table below differentiates Islamic economic system from capitalist and socialist systems.

	<b>Islamic Economic System</b>	<b>Capitalism</b>	<b>Socialism</b>
Property ownership	Private as well as public ownership of God giving resources	Completely private ownership of means of production	Absolutely state ownership of all means of production
Individual freedom	Right of individual to participate in economic activities within the boundaries of Shari'ah	Unlimited individual freedom to pursue his selfish economic interest	No individual freedom. Individuals are treated as state properties.
Decision making	Centralized and decentralized decisions making. Planning to achieve the goals of the system according to the dictates of the Shari'ah	Decentralized inform of individualistic decisions. Serving self-interest would ultimately serve the general societal	Decisions are highly centralized and everything is decided by the central planning authority.

		interest	
Motivation	Profit, Altruism, brotherhood, Ta'awun (Cooperation), accountability.	Profit, satisfaction of selfish interest, materialism	Love of the state, dictatorship, order
Coordinating mechanism	Demand and supply, Institution of Hisba (enjoying good and forbidden evil	Market forces of demand and supply	Central planning authority. Control and order
Scientific nature	Positive and normative, value loaded	Highly positive and objective,	Normative and subjective judgment with less objective analysis

#### Self Assessment Exercise

Differentiate between Islamic economic system and other systems

#### 4.0 Conclusion

This unit concludes that Islamic economic system is unique in its nature and approach and more comprehensive than the other systems because it moderate mundane material pursuance with spiritual pursuance which make it possible for the system to have a build-in stabilization mechanisms that eliminate exploitations of less privileges by well-to-do individuals. It overcomes the inherent weaknesses of socialist and capitalist systems by inculcating religious doctrines and principles that have divine and supernatural capabilities in its approach. Man by default, is created to serve his Lord and he cannot dodge from this fact. Therefore he can choose between serving his Lord or his heart desire.

## **5.0 Summary**

The discussed the meaning of Islamic economic system emphasizing its tailored and uncompromising religious attachment. It is an economic system loaded with Islamic norms and values that moderate man's economic activities with next-life pursuance. The unit also makes a comparative analysis between Islamic economic system on one hand and socialist and capitalist economic systems on the other hand by discussing their basic difference between them.

## **6.0 Tutor Marked-assignment**

- (1) Discuss the meaning and unique structure of Islamic economic system
- (2) Explain the salient features of Islamic economic system
- (3) Differentiate in details between Islamic economic system and other economic systems.

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## **UNIT TWO: Philosophical foundations, Operational Principles and Goals of Islamic Economy**

1.0 Introduction

2.0 Objectives

3.0 Main content

**3.1** Philosophical Foundations of an Islamic Economy

**3.2** Operational Principles of an Islamic Economy

**3.3** Goals of an Islamic Economy

4.0 Conclusion

5.0 Summary

6.0 Tutor Marked-assignment

7.0 Reference/Further readings

### **1.0 Introduction**

Like any other system, Islamic economy is built upon some philosophies, to be operated based on some specific principles and achieve some predefined goals. The philosophical foundations include; Tauhid, Ibadah, Khilafah and Tadhkiyya. While the operational principles are: Adl/Ihsan, Tskaful/Ta'awun, Responsibility/Accountability and Moderation. The goals of the system includes: Socioeconomic justice, growth/development, efficiency/stability and employment generation. This unit discusses these items one by one in order to provide full understanding of the system.

### **2.0 Objectives**

At the end of this unit students are expected to understand:

- Philosophical foundations of Islamic economy
- Operational principles of Islamic economy
- Goals of the system

### **3.0 Main content**

#### **3.1 Philosophical foundations of Islamic economics system**

The Philosophical foundations upon which Islamic economics system is built are:

(a) *Tauhid*

(b) *Ibadah*

(c) *Risalah*

(d) *Akhirah*

(e) *Khilafah*

(f) *Tadhkiyya*

(a) *Tauhid*: Literally means oneness or unitization. Lexically means admitting the unity of Allah and acceptance of all His virtues unconditionally. It requires man to surrender to One and only One God, in the capacity that only He is the Lord and administrator of this universe, the Creator and Sustainer, the Master of life and death. As such, only He is entitled to be worshiped and only He enjoys the authority to command and direct. Man is expected to bear in his mind that whatever he is doing Allah is watching him and will account for all his actions in the day judgment.

(b) *Ibadah*: This concept entails worshiping Allah alone through observing His Will in all activities. It is not restricted to observing five daily obligatory prayers or performing Hajj but it covers all human activities such as socioeconomic and political activities. Man should bear in his mind that what he do whether mundane or spiritual must conform to the teachings of Islam.

(c) *Risalah*: This entails divine message from Allah to His servants through His Messengers and Prophets to guide mankind in performing their religious duties. The message covers all aspects of human life both present and the next life. It

is the only source of information available to man to know about the Will of the Lord.

(d) *Akhirah*: Believe in the last day and its consequential judgment also serves as a *reason de tar* for Islamic economic system. If man knows in advance that all his actions are recorded and would be presented before him in the last day without any omission, he may be mindful in all his doings. Judgment day is true and there is no doubt about its occurrence.

(e) *Khilafah*: Allah created man and made him to be His vicegerent on earth. Man is supreme over all living organisms and all resources are placed at his disposal for exploitation. Also, Allah rendered all forces of nature subservient to man and granted him the freedom of choice between the right path (i.e. surrender this freedom to the Will of Allah) and the wrong path (i.e. surrender this freedom to the dictates of his heart desires).

(f) *Tadhkiyya*: This means purification of soul through constant remembrance of Allah in the heart and its manifestation in all physical activities. Man as a Muslim is enjoined to follow the dictates of Allah in all activities both worldly and spiritual. Hence, economic man is not supposed to be selfish, unfair or unjust in dealing with fellow human beings.

### **3.2 Operational Principles of Islamic Economic System**

Islamic economic system is guided by certain operational principles that set the rules of the game. These principles are:

(a) *Adl/Ihsan*

(b) *Takaful/Ta'awun*

(c) *Responsibility/Accountability*

(d) *Moderation*

(a) *Adl/Ihsan*: Islam stands for the promotion of justice and benevolence in the society. *Adl* means keeping of a balance and equilibrium in all affairs and

interactions right and responsibilities, whereas *Al-Ihsan* implies cooperation, kindness, courtesy, well wishing for others in general, and sympathetic attitude with moral and material support towards kith and kin in particular. These concepts imply the prevention and eradication of cruelty and operation in the society.

(b) *Takaful/Ta'awun*: Islam also enjoined Muslims to help and support each other especially in doing what is good and removing harm. *Takaful* denotes Islamic principle of ensuring material or financial support in the event of losses and restoring confidence among contracting parties. While *Ta'awun* means helping each other in doing good (*Al-Amr bil Ma'aruf*) and forbidden evil (*An-Nahyi anil Munkar*).

(c) *Responsibility/Accountability*: Islam placed man responsible to the society and accountable to his Lord. Man's responsibilities towards his society entails all the necessary duties like earning his living in halal means and engage himself in promoting the well-being of the society. He also has to bear in mind that Almighty Allah will hold him accountable for all his deeds.

(d) *Moderation*: Islam wants to keep man within balance without exceeding limits placed on him. Moderation encompasses avoiding extreme state in both consumption and production behaviors of economic man. This will make him not to be so indulged in pursuing the vain glory of this world and taking material well being as his ultimate aim.

### **3.3 Goals of Islamic Economic System**

Islamic economic system attempts to achieve the following goals:

- (a) Socioeconomic justice
- (b) Growth and Development
- (c) Efficiency and Stability
- (d) Employment generation



(a) **Socioeconomic justice:** Based on the principle that all that exists in the universe belongs to Allah. Man being God's vicegerent on earth have been granted the ownership of this bounties. He must therefore use whatever is given to him as a trustee and not as an absolute owner. Islam insists on a powerful built in income redistribution mechanism, nevertheless some income inequality is allowed since it promotes individual initiative. Income redistribution, voluntary or compulsory, is not only an economic necessity, but also a means to spiritual salvation.

(b) **Growth and development:** There seems to be hardly any difference of opinion among all societies around the world that the primary purpose of development is to promote human well-being. The area where the difference of opinion exists is in what constitute real well-being and what appropriate strategy can be employed to realize and sustain it. Nevertheless, the difference would not have been there if all nations allow their religious doctrines to dominate and dictate their world views because Allah has told us in the holy Qur'an that He has sent guides to every nations (Qur'an 13:7). Islam has comprehensive redistributive mechanisms that could ensure the trickle down of growth proceeds to the masses.

(c) **Efficiency and stability:** Islam encourages man to work hard and earn his living. The prophetic hadith shows that strong believer is dearer and better than the weak one. Islamic economic system aimed at achieving economic efficiency in resources mobilization and utilization as well as ensuring stability of the system.

(d) **Employment generation:** This is achieved through the attainment of economic growth which mostly comes with employment opportunities. The objectives however is not to attain full employment at the cost of economic efficiency. Some reasonable level of unemployment is necessary to sustain the path of economic growth.

### **Self Assessment Exercise**

Explain how philosophical foundations and operational principles of Islamic economic system could be helpful in realizing the objectives of the system?

#### **4.0 Conclusion**

This unit concludes that Islam is a comprehensive religion that provides man with guidance and directions not only for his socio-economic well-being in this world but also for his ultimate salvation and eternal happiness in the hereafter. The unique nature and approach of philosophical foundations and operational principles of Islamic economic system couple with their divine affiliation make it easy for the system to overcome all the shortcomings of socialism, capitalism and mixed economic systems.

#### **5.0 Summary**

This unit discussed the philosophical foundations of Islamic economic system which are *Tauhid, Ibadah, Risalah, Akhirah, Khilafah* and *Tadhkiyya*. These concepts provide a foundation stone for building well comprehensive economic system capable of solving all socioeconomic and political problems of man. The unit also discussed the operational principles of the system which includes *Adl/Ihsan, Takaful/Ta'awun, Responsibility/Accountability* and *Moderation*. Lastly the unit also discussed the goals of Islamic economic system which includes but not limited to: socioeconomic justice, growth and development, efficiency and stability and employment generation.

#### **6.0 Tutor Marked-assignment**

- (1) List and explain the philosophical foundations of Islamic economic system
- (2) What are the operational principles of Islamic economic system?
- (3) Explain the goals of Islamic economic system

## **7.0 References/Further readings**

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## **UNIT 3: The Role of al-Hisba in Regulating the Economy**

### **Contents**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Meaning of Hisbah
  - 3.2 Historical Development of Hisbah Institution
  - 3.3 Role of Hisbah in Regulating the Economy
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor Marked-assignment
- 7.0 Reference/Further readings

### **1.0 Introduction**

The institution of *Hisbah*, commonly known as an Islamic institution shouldering the responsibility of enjoying goods and forbidden evils in social and spiritual dimensions of the society. Its functions goes beyond that to include economic regulations and correcting business misconducts in the society. This unit discusses the economic role of *Hisbah* institution in regulating economic and daily business conducts.

### **2.0 Objectives**

At the end of this unit, students are expected to understand:

- Meaning of *Hisbah* institution
- Historical development of *Hisbah*
- Its role in regulating economic and business activities

### **3.0 Main Content**

#### **3.1 Meaning of *Hisbah***

Literally, the word *Hisbah* connotes “accountability” or “reward.” Technically however, it describes the state institution to promote the proper conducts and to avoid all types of misdeeds or offences. It represents the institution that existed through most of Islamic history for commanding what is good and preventing what is evil in line with the Qur’anic directive: *"Let there arise out of you a band of people inviting to all that is good, enjoining what is right, and*

*forbidding what is wrong: They are the ones to attain felicity.*" [Al-`Imran 3:104]; and the statement of Allah's Messenger (peace and blessing of Allah be upon him): "Whosoever among you sees an act of wrong should change it with his hands. If he is not able to do so, then he should change it with his tongue. If he is not able to do so, then with his heart, and this is the weakest of faith" [Bukhari and Muslim].

Although the Qur'an and the Prophet's tradition from the above quotations expect and enjoin every Muslim to play a positive role in the propagation of good and suppression of evil, it has been made an obligation on a section of society (*Fard Kifaya*) to remain engaged in it. So, while the Qur'an and Sunnah generally envisage that every Muslim has responsibility for the propagation of right and the eradication of wrong, the state is however, empowered to establish arrangements to oversee its implementation. In order to enable the state to coordinate its efforts in discharging its responsibility of enjoining good and forbidding bad, Islam established for it the special *Hisbah* agency whose duties are carried out by carefully selected people (*Muhtasib*) according to a clear set of conditions in order for its activities to be properly managed by the state. Thus, *Hisbah* is a religious position that embodies the application of the Islamic principle of enjoining what is good and forbidding what is evil, which is obligatory on the person that oversees the affairs of Muslims to appoint whoever he sees qualified for this post.

### **Self-Assessment Exercise**

What do you understand by *Hisbah* institution?

### **3.2 Historical Development of Hisbah Institution**

Historically, the first to hold the position of *Hisbah* with respect to its economic role in the Muslim society was the Messenger of Allah (peace and blessing of Allah be upon him). Prophet

Muhammad (peace and blessing of Allah be upon him) himself used to undertake inspections of markets to see that traders did not engage in improper behaviour and whenever he sees someone involved in an unethical practice, he

would ask the person to abstain from such behaviour. Muslim, Abu Daawud, Tirmidhi and Ibn Maajah reported from Abu Hurayrah (may Allah be pleased with him) that the Messenger of Allah (peace and blessing of Allah be upon him) passed by a pile of food and then put his hand in it until his fingers wetted, he said: “What is this, O owner of the food?” He said: “It was wetted by rain, O Messenger of Allah.” He said: “Would you not put it on top of the food so people can see it. The one who cheats is not from us.” Afterward, when his personal engagements increased to the extent that he cannot discharge the market supervision *Hisbah* responsibility, he appointed others to perform the role. Ibn Hajar documented in *Al-Isaabah* that the Prophet (peace and blessing of Allah be upon him) later appointed Sa‘id ibn Sa‘id ibn Al-‘Aas (may Allah be pleased with him) to oversee a market in *Makkah*. Not only men, even women participated in the role of market supervisors as ombudsman in the early days of Islam. During the time of the Prophet (peace and blessing of Allah be upon him), Samra' bint Nuhaik al-Asadiyyah (may Allah be pleased with her) used to tour the market to enjoin the good and forbid the evil, hitting the people with her whip (whenever necessary); a position she retained until her death during the reign of `Umar ibn al-Khattab (may Allah be pleased with him). To encourage her more, Caliph `Umar (may Allah be pleased with him) used to come to her workplace whenever he entered the market.

The *Hisbah* system of market supervision continued throughout the eras of the four Rightly- Guided, the Umayyad caliphs and the Abbasid Dynasty. For example, the second caliph, `Umar ibn Al-Khattab (may Allah be pleased with him) used to undertake the job of the Ombudsman in the market himself. Ibn Sa‘id in his *Tabaqaat* narrated that `Umar used to prevent fraud and warn against it, and go round the market carrying a stick to warn those who cheat and/or engage in unethical business practices. He also appointed Abdullah ibn Utbah Al-Huzali, Saa‘ib ibn Yazeed and Sulaiman ibn Abi Khaithamah (may Allah have mercy on them) to perform the economic role of supervising the Madinah market. The period of the four rightly guided Caliphs was followed by the Umayyad Caliphate. During their period, the institution of *Hisbah*

suffered some setback. Its functions were relegated to mere inspection of weights and measures devoid of any religious dimension and its status as secular.

The purpose of the *Hisbah* institution is to protect members of society from deviance, preserve their faith and guarantee the welfare of the people in both religious and worldly matters according to the *Shari'ah*. The *Hisbah* serves as a control mechanism Islam established to maintain the order of social life, so that everyone will enjoy security and the fulfillment basic needs.

At the beginning, activities of *Hisbah* were dominated by encouraging moral behaviour and discouraging immoral ones, preaching righteousness and advising against wrongdoing. Over the years however, the development of *Hisbah* went beyond the religious meaning of commanding good and forbidding evil to practical duties consistent with the general interests of the Muslims.

In the course of time, *Hisbah* began to deal with various social matters that include maintenance of cleanliness of roads, animal welfare such as making sure that an animal was not made to carry what it could not bear, health care that involves covering fountains, preventing teachers from severe beating of children, and controlling bars and wine drinkers as well as indecent women.

The *Hisbah* institution continued during the entire Muslim period of history, though with different descriptions and in different names.

With the arrival of Western colonialism and the instantaneous disappearance of Islamic political strength, most of the Muslim institutions suffered drastic decline. *Hisbah* also declined in effectiveness and virtually disappeared since its existence or effectiveness relates directly to and depends squarely on the strength of the governance. Where it continued to exist, it further disintegrated into a number of departments and in some places remained an ineffective appendage of the state organs. For instance, by the 19<sup>th</sup> century, Persia, Turkey, Egypt and India had already reassigned the functions of *Hisbah* to various secular departments, making its religious content irrelevant, while in North African Morocco the office of the Ombudsman remained until the early

part of the 20th century. Saudi Arabia is said to be the only Muslim State, which to a greater extent has retained intact the religious wing of the *Hisbah*, though its secular functions have been distributed to different departments and ministries.

Ironically, Europe adopted the *Hisbah* system from the medieval Muslims, especially at the time of the Crusades. During their occupation of Jerusalem, the European Crusaders kept the office of *Hisbah* and mandated *Hisbah* officers to go to markets in the morning to check the butchers' shops and other shops of drinking and eating; take care of fraud goods brought by vendors and peddlers to the market; and make sure that bread is always available in the market and the weight of bread must meet the standard weight set by the governing council. The institution of *Hisbah* in Islam is undoubtedly the culmination of what can be thought of prudent governance, showing keenness on the convenience and security of people, preservation of their well-being, avoidance of all causes of anxiety and distress, and protection of society morally, spiritually and materially.

Presently In Nigeria, after the implementation of *Shari'ah* in some northern states, only three states, Kano, Jigawa and Zamfara have the most comprehensive *Hisbah* institution.

### **Self-Assessment Exercise**

Give an account of the historical antecedents of *Hisbah* institution to the present time.

### **3.3 The Roles of *Hisbah* Institution in Regulating Economic Activities**

- a) Right weights and measures
- b) Checking business frauds
- c) Correcting market imperfections
- d) Hoarding
- e) Unfair monopolies
- f) Information monopoly



- g) Essential goods supply and price
- h) Ownership rights

(a) Right weights and measures: The *Hisbah* institution is saddled with the responsibility of setting and ensuring compliance with standards quality and measures of goods and services brought to the market. This will go along line in protecting consumers against exploitation and cheating in the market.

(b) Checking business frauds: *Hisbah* institution is also responsible for checking business frauds such as deceiving, outsmarting, misrepresentation, overvaluing, etc in order to ensure fair play among market participants

(c) Correcting market imperfections: One of the orthodox assumptions of premarket economy is the existence of perfect market where everyone has complete information about the market but in reality, perfect market never exist as assumed by the classicalists. However, Islamic economic system, knowing this fact, sets *Hisbah* institution to correct imperfections of the market.

(d) Hoarding: This is act of storing and warehousing essential goods away from the marketplace for some future period to attract higher prices. It is a detrimental behavior of businessmen used to exploit innocent consumers and Islam as a just religion, set *Hisbah* institution and assigned it the responsibility of stopping and preventing hoarding activities.

(e) Unfair monopolies: Monopoly is a market situation where there is only supplier of a particular product. The absolute right to supply the product is conferred on only one person or business entity. In order to protect consumers against exploitative tendencies of monopolies, Islamic states established *Hisbah* institution and saddled it with the responsibility of checking unfair monopolies.

(f) Information monopoly: This is another type of monopoly where the market or product/and service information controlled by one contracting party at the detriment of the other party and it is one of the consequences market imperfection. *Hisbah* institution checks and prevents the concentration of market information at the hand of few people.

(g) Essential goods supply and price: This economic function of *Hisbah* institution also goes a long way in protecting disadvantaged section of the society.

(h) Ownership right: *Hisbah* institution is also saddled with the responsibility of preventing piracy and violation of copyright ownership.

### **Self-Assessment Exercise**

List and explain the economic roles of *Hisbah* institution

### **4.0 Conclusion**

This unit concludes that with the ombudsman institution like *Hisbah*, the economic and business activities will be done orderly and the economy is protected against artificial fluctuations and destabilization.

### **5.0 Summary**

The unit discussed the meaning and historical development of *Hisbah* institution. It also discussed the roles of *Hisbah* institution in regulating economic and business activities such as right weights and measures, checking business frauds, correcting market imperfections, hoarding, Unfair monopolies, Information monopoly, Essential goods supply and price and ownership rights.

### **6.0 Tutor Marked-assignment**

- (1) Define the *Hisbah* institution
- (2) Discuss the historical development of *Hisbah* institution
- (3) Explain the roles of *Hisbah* institution in regulating economic and business activities

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## **MODULE THREE: INTRODUCTION TO MICRO AND MACRO ISLAMIC ECONOMIC ANALYSIS**

**UNIT 1** Consumer and Producer Behaviours

**UNIT 2** Market Mechanisms from Islamic Economic Perspectives

**UNIT 3** Islamic Macroeconomics Fiscal and Monetary Policy

**UNIT ONE:** Consumer and Producer Behaviours

### **Unit Contents**

**1.0 Introduction**

**2.0 Objectives**

**3.0 Main Content**

**3.1 Theory of Consumer Behaviour**

**3.2 Theory of Production**

**4.0 Conclusion**

**5.0 Summary**

**6.0 Tutor Marked-assignment**

**7.0 References/Further readings**

### **1.0 Introduction**

Almighty Allah created man and made him supreme on this earth purposely to test him. Man struggle, like all other animals, to fulfill the basic requirements of his live. There are at least three internal instincts common to all living organisms including man, which instigate them to struggle for their fulfillments. These include the protection of live through offence and defense, sustenance of life through food, shelter and other requirements, continuation of life through reproduction and catering of offspring. All human endeavors are for the fulfillments of these basic requirements of life. According to the western philosophers, specifically Charles Darwin, proposes blind struggle by man to fulfill these basic needs of life without any consideration of his fellow human beings because at the long run, “only the fittest survived”. But Islam proposes moderation in both mundane and spiritual pursuance with diligent consideration of the needs of other creatures not only man. This unit will

discuss the consumption and production behaviors of man according to the Islamic economic perspectives.

## **2.0 Objectives**

At the end of this unit students are expected to understand:

- The nature of consumer behavior according to Islamic economic perspectives
- The nature of producer behavior according to Islamic economic perspectives
- Difference between economic man and Muslim man.

## **3.0 Main Content**

### **3.1 Theory of Consumer Behavior**

Consumption of commodities is the final target of all economic activities. This is the aspect related to fulfillment of wants and therefore the most important part of material life. Islam provides the necessary guidelines for all walks of life, and both the acquisition of resources as well as spending them for needs the attention in *Shari'ah*. Islamic economics laid down some basic assumptions of Muslim consumption behavior and provides principles to guide his consumption pattern to please Allah.

#### **i) The key assumptions are as follows.**

1. Consumer behavior is based on economic rationalism and fear of Allah. A consumer designs his consumption pattern to please Allah, the omnipotent. It is a matter of gratefulness; it is also an act of worship (Ibadah).
2. A consumer is regarded as an economic and moral utility maximizer. He determines his consumption in terms of moral and ethical principles. Ethics can be defined as the moral principle that makes a distinction between right and wrong and between good and bad.
3. He can control his wants as well as demand.
4. Utility or satisfaction derived from worldly (life before death) and Heavenly (life after death) consumption.

5. He consumes only useful things while avoids harmful goods and services, for himself and for whole society. Moreover, he will be co-operative and socially responsible, who always consider the disadvantages of other consumers in the society.
6. Spend in moderation neither as miser nor extravagant, both for here (worldly) and the hereafter (Heavenly).
7. Strictly consider Halal (legal) and Haram (illegal) in consumption
8. He does not hoard his wealth.
9. He prefers leading a simple as well as moderate life.

A consumer who satisfies these assumptions is considered as an Islamic consumer. More precisely, Islamic consumer refers to the consumer whose behavior is not against the principles of Islam. Below are the explanations of these assumptions from Qur'an and Sunnah.

**Useful (goods and services) are Permissible (Halal) and harmful are Prohibited (Haram):**

Islam encourages the consumer to consume good and useful things and discourages wasteful and unnecessary expenditure to insure good quality and purity (AL-Quran: 2: 172, 5: 4-5, 16: 114). In the Holy Quran, The word Tayyeb (Best and useful) is used to denote the good and pure things which means anything one finds pleasing, sweet, good, agreeable in sight, smell and eating and which is useful for health. As ALLAH says in the Holy Quran: *ye Messengers enjoy (all) things good and pure* (AL-Quran: 23: 51).

On the contrary, In the Holy Quran, the word Khabaa-es (bad and harmful) is used to represent the bad and impure things which means anything one finds displeasing, bad, disagreeable in sight, smell and eating and which is harmful for health. The verse of ALLAH is: *He makes lawful to them the good things and prohibits for them impure things* (AL-Quran: 7: 157). Some forbidden foods are: dead meat, blood, the flesh of swine, and that on which has been invoked the name other than of Allah..." (Al-Qur'an 5:3). The prophet (pbuh)

said, all drinks that intoxicate are Haram (unlawful) and every intoxicants are haram (Al-Bukhari: 492, Muslim: 4956)

Consumptions of impure, harmful and bad goods and services are strictly prohibited, which endanger the social security and welfare of the state and spending on that goods are considered as waste(Al-Quran: 2: 60, 6: 142, 2: 168).

### **Consumption for Here (Worldly-life before death) or Hereafter (Heavenly-life After Death):**

A consumer, who follows Islamic and moral principles, usually believes in two periods, here and life here after for his consumption choices. For this consumer, life before death and life after death are closely interrelated in sequential manner.

There are two effects of his choices. Firstly: It's immediate effect in this life and its later effect in the life to come. The utility derived from such a choice is the total of the present values of these two effects. Secondly: The number of alternative uses of one's income is increased by the inclusion of all the benefits that will be gained only in the hereafter. Some of such alternative uses are: *Interest free loans, donation to the poor and needy, spending for the welfare of the future generation, improvement of the community life, propagation of the message of Islam, promotion of goodness and demotion of evils, time and effort for the improvement of the spiritual, moral and economic life of the community.*

### **Unlimited Wants and Balanced Consumption:**

Wants in economics refer to human needs plus the will and power to satisfy those needs. Human wants are unlimited. There is practically no end to human wants and it is also true that a consumer can never satisfy them all. As the Holy Prophet (pbuh) said; *if Allah were to give man a valley full of gold, he would ask for the second, and if he were given the second, he would ask for the third; man would never be satisfied until he was dead* (Al-Bukhari, 5992-5996).

According to Islamic economics, wants consist of four types of necessities in life. These are Necessities of life, Necessities of efficiency, Comforts and Luxuries. Those wants which are absolutely necessary for human life and man cannot survive without it, e.g. food, clothing and shelter etc. are called necessities of life. These necessities which are essential for increasing the efficiency of work are called Necessaries of efficiency, e.g. good food, meat, milk, butter, good bed for sleeping, shoes, and fruits etc. Comfort includes those things whose utility in general is greater than their cost. Good and delicious food, good and expensive clothing and well-furnished buildings and mansion houses are his comforts. Excessive in personal gratification or excessive expenditure on unnecessary and superfluous wants is called luxury. The costs of luxuries are usually greater than the benefit, e.g. costly dress, wine, utensils of gold and silver etc.

Islam has forbidden the use of Luxuries as they encourage the growth of unproductive and immoral industries and spread mischievous and disruptive elements in society which ultimately destroy the unity and integrity of the entire community. ALLAH says, Eat and drink: but waste not by excess for, God loves not the wasters (AL-Qur'an, 7:31). Besides, luxury may makes a man idle, wasteful and extravagant and promotes bad habits of ease loving, dependence on other, laziness, hatred for work, irresponsibleness etc.

A person may commit a crime and thus spread bribery, corruption, nepotism; red-nepotism etc. It may create high economic inequality and thus make an unrest in the society. In view of these evils, the holy prophet (pbuh) discouraged and prohibited the use of vessels of gold or silver, wearing of a golden ring and silken clothes, which were considered luxuries (Al-Bukhari, 5032). Allah says: And He enforced the balance. That you do not exceed the bounds; but observe the balance strictly; and fall not short thereof (AL-Qur'an, 55:7-9).

**Moderation:** Islam encourages the Moderate living standard, because it's spending is neither extravagant nor niggardly but the balanced between them



for consumer (Al-Qur'an, 17: 29, 65: 7). As Quran reveals; and those who, when they spend, are neither extravagant nor niggardly, but hold a just (balance) between those (extremes) (Al-Qur'an, 25: 67). Besides, in the field of consumption, Moderation checks the evils of wrongful expenditure i.e. hoarding and extravagance and thereby saves the community from the hardships and evils of unemployment and corruption. ALLAH says: Thus we have made you a balanced nation, that you be witnesses over mankind and the Messenger be a witness over you (*Al-Qur'an*, 2:143).

Abu Darda reported that the Holy Prophet (pbuh) said, It is a part of intelligence and wisdom of a man that he should adopt moderation in his economy, it is half of the happiness of economic life and the best course in everything (Al-Bukhari:6019). Abu Saeed Khudri reported that the Holy Prophet (pbuh) advised people to adopt moderation in consumption and said, good comes out of good but wealth of this world is like green grass, if an animal eats it in excess, it kills him or brings him nearer to death. The animals which eat green fodder, walk in the sun, digest their food, pasture again, are perfectly well. So in the case of wealth, it is a sweet fodder, the best man is one who earns wealth lawfully and spends it on lawful (good) things. This wealth will bear witness against one (who has misused it) on the Day of Judgment (Al-Bukhari: 5997).

**Simple Life:** Historically, simple living standard was one of the characteristics of the prophets (pbuh). The prophet Muhammad (pbuh), like many other prophets before him, always liked simple and moderate living. His four caliphs maintained his tradition of simple living after him. So it is the best policy for a Muslim consumer to lead a simple and moderate life.

The Holy Prophet (pbuh) once remarked: “Successful is the man who has acted on the principles of Islam and lived on simple necessities of life (Ibn-Mazah: 4934). Furthermore, The Prophet (pbuh) said: “The rocky land of Mecca could be turned into gold for me if I had wished, but I said, O Lord! I wish I had enough to fill my stomach one day and remain hungry the other day,

so that I might remember you when hungry and be thankful to you when my stomach was full (Al- Tirmidhi:4935, Al-Bukhari:6001-2). Moreover, He said, I saw that, most of the residents of heaven (Jannah) are poor (Al-Bukhari: 6005).

A case study from the life of Omar, who was the second caliph of Islam reveals that Utbah-bin-Farqad, a governor of a province, once visited the Caliph while he was taking his meals. The governor seeing his coarse food, remarked, “Why don’t you take food made of fine flour”? Omar replied, “Ibn-Farqad! Is there anyone with greater resources than myself in the land of Arabia at present? Utbah said that there was none with greater resources than you. Then Omar enquired from him saying, “Ibn-Farqad! Do all the Muslims get fine flour (to eat)? He replied in negative. Then Omar said, “I would be a bad ruler if I were to take nice (and good) things for myself and leave the bad ones for the people (Tabari, 1990).

### **Hoarding**

An Islamic consumer does not hoard wealth. The people, who are hoarding, are responsible for lowering the level of consumption, production and employment in the community. The verse of the Al-Qur’an is: Woe to every slanderer, defamer, who amasses wealth and counts; thinking that his wealth would make him last forever (Al-Qur’an, 104: 1-3). The prophet (pbuh) said: *He who hoards is a sinner. No one hoards but the sinner* (Muslim: 3910-12). *Do not withhold your money by counting it (i.e. hoarding it), (for if you did so), Allah would also withhold His blessings from you* (Al-Bukhari: 514). Hoarding up food (to sell it at a high price) in the sacred territory is a deviation (from right to wrong) (Abu-Dawud: 2015). *He who brings goods for sale is blessed with good fortune, but he who keeps them till the price rises is accursed* (Ibn-Mazah: 2153).

### **Consideration of Halal (legal) and Haram (illegal):**

The consumption of goods and services, which are allowed in Islamic Shariah, is called Halal and which are not allowed is known as Haram. The Prophet

(pbuh) warns that a time will come when one will not care how one gains one's money, legally or illegally (Al-Bukhari-3:275). But the believer will follow the Halal (legal) and Haram (illegal) and be careful in their consumption.

### **Consumption Pattern: Different from Capitalist/ Communist:**

A capitalist passes his whole life to accumulate more and more wealth and believes that his wealth will make him abiding in prosperity which will never come to an end but will remain forever (Al-Qur'an, 89: 20). As Allah says, *He thinks that his wealth will make him abide* (Al-Qur'an, 104: 3). Similarly; a communist uses wealth in thinking that, there is no accountability in here and here after life and does not believe in Allah. On the contrary, an Islamic consumer consumes the resources of the world as a vicegerent of Allah and believes in dual accountability. As a result, though the utility from a certain goods or service is high to a capitalist or communist consumer, an Islamic consumer may gain a zero or negative utility from the same goods or service, e.g. utility from consuming wine. Moreover, an Islamic consumer prefers life hereafter as a real and endless life over worldly life (Al-Bukhari: 5971-5973). The Prophet (pbuh) said: *Richness is not having many belongings, but richness is the richness of the soul (contentment)* (Al-Bukhari: 6002). The Prophet (pbuh) also said: No human being has ever filled a container worse than his own stomach. The son of Adam needs no more than a few morsels of food to keep up his strength, doing so he should consider that a third of his stomach is for food, a third for drink and a third for breathing (At-Tirmidhi-2380, Ibn-mazah-3349).

### **Self-Assessment Exercise**

Discuss the basic assumptions of Islamic consumer behavior

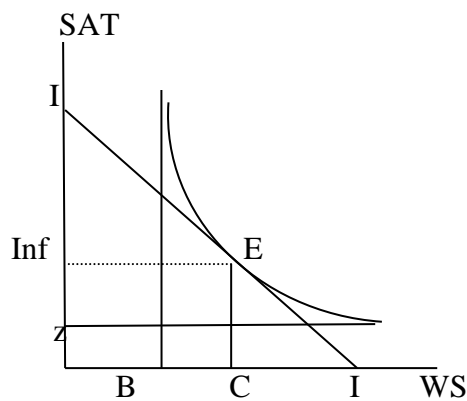
### **ii) Models of Consumer Behaviour with Islamic Norms: The Structural Model**

The underling paradigm of Islamic economics is *Shari'ah*. The behaviour of Islamic man forms the micro-foundations of the Islamic economy. Contrary to

conventional economics which discusses the subject matter positively, Islamic economics includes both positive and normative aspects. However, for the purpose of analysis, conventional utility theory will be employed because there is no harm in the use of modern analytical tools provided their extensive use does not obscure normative principles.

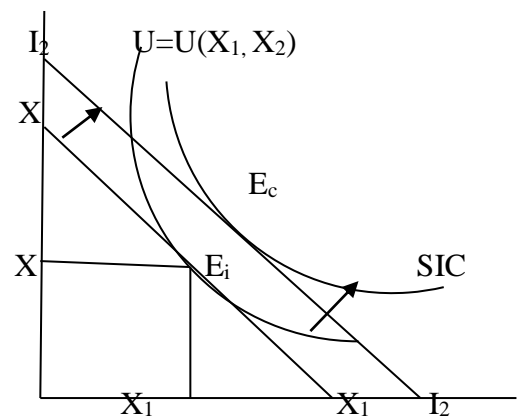
Firstly, we may begin by assuming that the Muslim consumer allocates his available resources in such a way as to get maximum satisfaction (*falah*) in this world and the hereafter. That is to spend for himself and for the welfare of the fellow human beings particularly the poor and destitute which is much emphasised by Islam. The minimum compulsory amount imposed by Shari'ah, to be spend on such categories of people in form of *Zakat* or *Ushr* and which may be paid in cash or kind by a person whose assets are above the exemption limit is 2.5% of the wealth or 10% of the harvest. This can be shown in the diagrams below.

**Figure A**



Allocation for this world and Hearafter and Infaq

**Figure B**



Normal Allocation after Zakah

From Figure A above, the vertical axis represent spending for the hereafter (SAT) while the horizontal axis represents worldly spending (WS). The Muslim consumer allocate his given resources (i.e. disposable income represented by income line II) for this present life and the hereafter and he is at equilibrium point E, where he spend  $OC$  for his worldly affairs and  $CE$  (which includes zakah  $Oz$ , and infaq  $OInf$ ) for his next life. Figure B shows the possible

adjustments of both income level and satisfaction level from lower level to higher level after normal allocation of Zakah and Infaq.

So far as spending for fulfillment of worldly needs is concerned, there are no hard and fast upper limits; although both luxurious spending and miserliness are discouraged.

### **Self-Assessment Exercise**

Describe the equilibrium condition of an Islamic consumption behavior

### **3.2 Producer Behaviour in an Islamic Economic Framework**

- a) Concept of Production
- b) Objectives of Production
- c) Factors of Production
- d) Factors of Production and their Pricing
- e) Behaviour of an Islamic Firm
- f) Producer equilibrium in an Islamic economics using *Mudarabah* and *Musharaka* financing.

#### **a) The concept of Production**

Production can be defined as the process and methods used to transform tangible inputs (such as raw materials, semi-finished goods) and intangible goods (such as ideas, information, services) into ready-to-use goods and services with the ultimate aim of earning maximum profit possible. It can also be defined as the process of adding value to goods and services for final consumption or uses with the sole aim of getting profit.

Production can be organized into different forms depending on the nature of ownership and management. However, three categories seem to be the most popular. These are; sole proprietorship, partnership and joint stock company.

Sole proprietorship is a type of business organization owned and managed by a single individual. He organizes the business, plans for the production or

supply, arranges for hiring other factors, competes in the markets and undertakes risk. He is the sole authority at every stage of decision-making and all these efforts entitle him for an economic gains or profits. This form of business, although primitive still prevails as the most common one and best fit for small-scale enterprises. The profit motive is the natural driving force, which is recognized by Islam, however within certain bounds and limitations.

Partnership is the business organized and runs by two or more individuals on the basis of profit and loss sharing. In the classical *fiqh* literatures, this form of business is known as *Musharaka*. While Joint Stock Company is the extended and modern form of partnership established by two or more individuals. They get it registered with the government, declaring the purpose and nature of business. The government authorizes the company to collect capital from the general public by floating the stocks on profit-sharing basis. These shares can be sold and repurchased in the stock exchange before maturity through brokers.

#### **b) Objectives of production in an Islamic economic framework**

There are three major objectives of production in Islamic economy;

i) To improve the material condition of an individual. Islam encourages man to work hard and utilize the God-giving resources to their fullest capacities. The following Qur'anic verses and hadith of the Holy Prophet (Peace and blessing of Allah be upon him) confirmed this.

*“Eat and drink of that which God has provided and act not corruptly, making mischief in the world (al-Qur'an 2: 60).*

*“O mankind! Eat of what is lawful and good on earth and follow not the footsteps of the devil (al-Qur'an 2: 168).*

*O you who believe! Forbid not the good things which God has made lawful for you and exceed not the limits. Surely, God loves not those who exceed the limits. And eat of the lawful and good that God has given you, and keep your duty to God in whom you believe (al-Qur'an, 5: 87-88).*

These verses of the Qur'an, and there are many others like these, strike the keynote of the Qur'anic message in the economic field. Islam urges Muslims to enjoy the bounties provided by God and sets no quantitative limits to the extent of material growth of Muslim society. It even equates the struggle for material well-being with an act of virtue.

“If God provides anyone of you with an opportunity for earning livelihood, let him not leave it unexploited until it is exhausted or becomes disagreeable to him” (Ibn Majah). *“Any Muslim who plants a tree or cultivates a field such that a bird, or a human being, or an animal eats from it, this act will be counted as an act of charity”* (Bukhari and Muslim). *“He who seeks the world lawfully to refrain from begging, to cater to his family, and to be kind to his neighbor, will meet God with his face shining like the full moon”* (Bayhaqi).

ii) To improve the morality of the producer and the society in general. The implication of this objective is that the products which deprive the human being of his moral values are strictly prohibited. The industrial activity related to those products and all types of relationship with that product are also strictly prohibited. For example, prostitution and income generated from it.

iii) To serve as a way of attaining *falah* (ultimate happiness in the hereafter) As a Vicegerent of Allah on earth, Muslim producer must not produce unlawful products or harmful products such as cigarettes and his production activities must not cause damage to the environment. Also profit maximization should not be his only focus and he should spend part of his reasonable profits on charity such as financial support to the less-privileged and destitute in the society. This will surely help him to be pleased by his creator and consequently attain *falah* in the hereafter.

### **Self-Assessment Exercise**

Distinguish between Islamic firm and conventional firm in terms of their conceptions and objectives

### **c) Factors of production**

Factors of production refer to an economic term to describe the inputs that are used in the production of goods or services in the attempt to make an economic profit. The factors of production include land, labor, capital and entrepreneurship. In an Islamic framework, factors of production can be identified according to their functions;

- i) Hired factors of production (HFP) that provide a productive service for which they are entitled to receive a definite reward (wages or rent).
- ii) Entrepreneurial factors of production (EFP) that choose to bear the risk of an entrepreneurial project rather than receive a fixed wage or rent.

HFPs are derived from resources which could also offer themselves as EFPs. The supply & demand for HFPs thus competes with the supply and demand for EFPs. All resources have to opt for HFP and *ujrah* (wages) or EFP and *ribh* (profit).

Money cannot be a HFP but can serve as an EFP if it bears risk; EFP implicitly recognizes money in the Islamic economic system as a factor of production to the extent that it is capable of bearing risk and entitled to profit as with physical capital and human resources (labour).

### **d) Factors of Production and their Pricing**

Islamic Factor markets: theories of the supply and demand of labour and capital in Islam are not dramatically different from conventional economics, except;

- The rental of capital goods on *ijarah* should be on the basis of operating leases not financial leases, real rental is the price of a real service not pegged to an interest rate.
- Marginal productivity will determine the demand for human resources and physical capital to be employed on an *ujrah* basis.



- The supply of capital is not a function of savings and a choice between present or future consumption, and so has no link with an interest rate, but rather the supply of capital is determined by the opportunity cost of producing capital goods.

According to Kahn (1990), productive inputs are group into two categories: 1) Input that does not get “consumed” in the production process (i.e. they are subject to wear and tear). These are called “factor inputs” and 2) Inputs that get “consumed” during the production process and loss their original shape. For example, flour in a bakery. These are called “consumed inputs”. Money is useless in production unless it is converted into either factor input or consumed input.

It is also convenient to classify factors according to the method of determining their prices. Under this framework two categories of factors are identified; 1) *Ujrat* – this refers to various kind of rents which include those for human services such as wages and payment to all other factor inputs. *Ujrat* are fixed and known in advance with certainty. They are always positive because the services or benefits provided by the factors have to be positive. 2) *Ribh'* or Profits – these are uncertain and are not known or fixed in advance. Profit can be positive or negative.

### **Self-Assessment Exercise**

Explain the factors of production and their pricing from Islamic economic perspectives.

### **e) Behaviour of an Islamic Firm**

Islamic firm can be defined as the community of autonomous individuals who are contractually bound to co-operate with each other to employ and account for the factors of production to produce goods and services with the ultimate objective to sell and profit keeping in mind the limits and bounds set out by the *Shari'ah*. One of the peculiar features of an Islamic firm is that the principle assets of an Islamic firm are not its physical resources and capital but

entrepreneurial skills of the individuals who make up the Islamic firm. Another distinguishing feature of an Islamic firm is that its capital structure is based on one of the three equity-based modes of financing namely; Profit Sharing (PS), Profit and Loss Sharing (PLS) and Output Sharing.

PS is based on the principle of *Mudaraba*. This is a financial arrangement in which one party *Rabbul Mal* (financier) provides capital while the other *Mudarib* (manager) provides entrepreneurial skills and run the business. ***The profit accrued from the business is shared based on pre-agreed ratio while loss is entirely borne by the financier unless if it occurred as a result of negligence or mismanagement of the manager.***

PLS is based on partnerships known as *Musharakah* where two or more peoples wishing to start business pull their financial resources together and the business. The profit may be shared based on pre-agreed ratio but loss must be borne by the parties involved according to their capital contributions. While OS is mostly used in agricultural related financing which is known as *Masaqa*.

Muslims producers are bound by Islamic ethics and morals in the market place. Conventional producers seek profit maximization, while Islamic producer engages in profit sharing and a reasonable profit. Producers must not produce unlawful products or activities. Producers must spend part of their wealth to the less fortunate members in the Islamic society. Generally, from Islamic point of view, both the owner of the capital and the Muslim entrepreneur are the *khalifahs* who should see business as part of worship (*ibadah*) or good deed and at the same time to bear the risk of profit and loss in production or in the business venture.

Imam Ghazali commented on the various kinds of production activities, including their hierarchy.

- He considers economic pursuits as part of an individual's worship (*Ihya*, 2:61), and the production of necessities as a socially obligatory duty (*Ihya*, 2:83).
- The State must assume responsibility to ensure that necessities are produced in sufficient quantities.

- He classifies a hierarchy of primary (agriculture), secondary (manufacturing) and tertiary (services) production activities into three broad groups (*Ihya*, 1:12,13,16);

**Basic industries:** important to sustain life - agriculture (food); textiles (clothing); construction (shelter) and infrastructure to facilitate production of necessities.

**Ancillary activities:** basic industries - iron industry; mineral extraction; forestry resources.

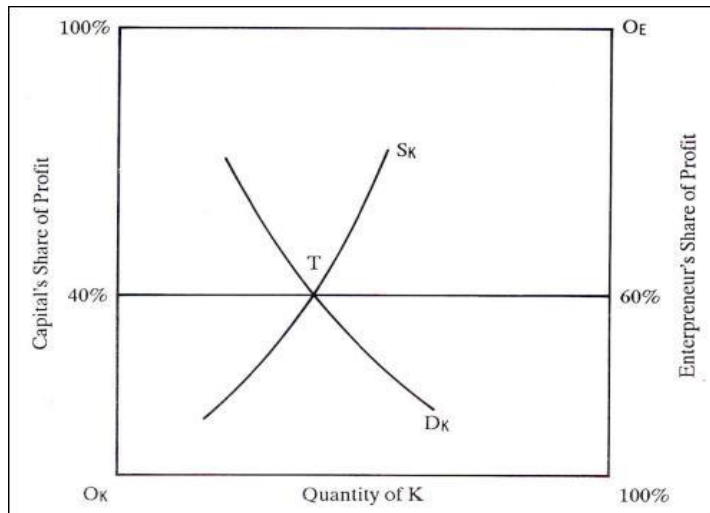
**Complimentary activities:** to basic industries, such as the grinding and baking of agricultural products.

**(f) Producer equilibrium in an Islamic economics using *Mudarabah* and *Musharaka* financing.**

**- Determination of profit/loss shares in *Mudarabah* mode of financing**

In this case the *khalifah* is the owner of the capital (*rabb al-mal*) and gives his property to another *khalifah*, the entrepreneur (*mudarib*), to manage the business, and each will have an agreed share of the profit. In case there is a loss, the owner of the capital will bear the loss and the *mudarib* will lose his time and effort. The *ex-ante* (before the event) determination of the share capital in the case of *mudharabah* will be determined by the interaction of the demand for (D<sub>k</sub>) and supply of capital (S<sub>k</sub>). The figure below depicts the equilibrium condition of *Mudarabah* financing.

**Figure C**



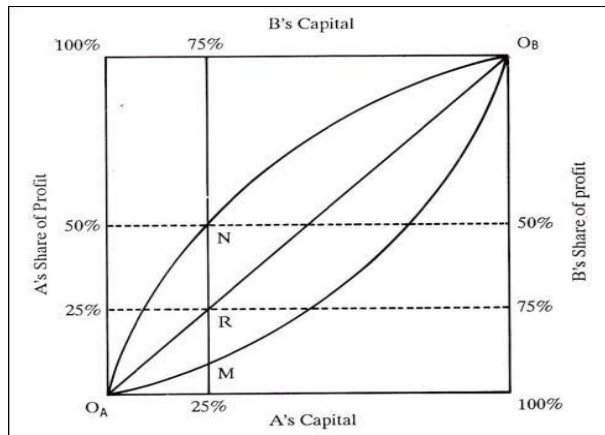
**Source: Sadeq, 1990:54**

From the Figure, Prices (profit shares) of capital and entrepreneurship in percentage terms are measured along the left and right vertical axes, and the amount of capital along the horizontal axis.  $S_K$  is upward sloping implying that the quantity of capital supplied increases as the capital provider's profit-share increases.  $D_K$  is downward sloping implying that the quantity of capital demanded increases as the capital provider's profit-share decreases.  $S_K$  and  $D_K$  intersect at T, determines the profit-share ratio: e.g. 60:40. The risk of losses is incurred by the capital provider and the entrepreneur's service will go unrewarded.

**- Determination of profit/loss shares in *Musharakah* mode of financing**

In this case two or more partners (*khalifahs*) combine their capital in a business. They jointly manage their business and they jointly bear the risk of profit and loss in a pre-agreed proportion. The loss is apportioned according the ratio of capital contributed by each partner, and the profit is distributed according to a pre-agreed ratio by mutual consent. The *ex-ante* determination of profit & loss sharing for *musharakah* are based on factor pricing of capital and entrepreneurship that is based on justice. The income distribution for *musharakah* and *mudharabah* are equitable, because each partner receives a share in the profit on the basis of the partner's contribution to the production process. The figure below depicts the equilibrium condition *Musharakah* business.

**Figure D**



From the Figure, Upper & lower horizontal axes represent capital provided by A & B, whilst left & right axes depict their respective profit-shares. If Shafi'i or Maliki, partners should share in profits according to their respective contribution of capital, given by  $O_A$ -R- $O_B$ , assuming A contributes 25% of the capital and thus A receives 25% of the profit. If Hanafi or Hanbali, partners may vary their profit share reflecting entrepreneurial ability, e.g. either  $O_A$ -N- $O_B$  or  $O_A$ -M- $O_B$ . The distribution of any losses is based on the share of capital contributed, because the share of entrepreneurial services will go unrewarded. For losses  $O_A$ -R- $O_B$  would thus apply.

### Self-Assessment Exercise

Discuss, with the help of diagrams, the behavior of an Islamic firm.

### 4.0 Conclusion

This unit concludes that Islamic economic man, whether in his capacity as a consumer or producer, is fundamentally different from his conventional counterparts in the sense that he is bound by Islamic law to uphold some principles which direct him toward doing good to himself and the society and refrain from activities which could endanger the societal norms and values. The focus of an Islamic economic man and his foresight is wider than that of his conventional counterpart because he is not only aiming for profit maximization but also improving the social standards and the general well-being of the society. Moreover, if the world in its entirety could imbibe and uphold the

economic guidelines and principles of Islamic economic system, the economic problems of the world would be solved almost completely.

## **5.0 Summary**

This unit discussed the consumer and producer behavior from Islamic economic perspectives and shows that the baskets of goods of an Islamic economic man is smaller than that of his conventional counterpart because he could not consume prohibited goods no matter their level of satisfaction to him. The Muslim consumer could not attained highest level of satisfaction without spending for well-being of the poor people. So also Muslim producer could not attain equilibrium without producing goods and services allowed by the *Shari'ah* and also spend part of his profit for the well-being of less privilege people in the society.

## **6.0 Tutor marked-assignment**

- 1) List and explain the assumptions of Islamic consumer behavior
- 2) With the aid of diagrams, explain the equilibrium condition of Islamic consumption behavior
- 3) Distinguish between Islamic economic man and conventional economic man in terms of their consumption and production behaviors.

## **7.0 References/Further readings**

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## **UNIT TWO: Market Mechanisms from Islamic Economic Perspective**

### **Unit Contents:**

1.0 Introduction

2.0 Objectives

3.0 Main Content

3.1 Meaning of market mechanism

3.2 Different types of markets and their appraisal from Islamic economics

3.3 Role of Islamic state in regulating market activities

4.0 Conclusion

5.0 Summary

6.0 Tutor marked-assignment

7.0 References/Further readings

### **1.0 Introduction**

This unit discusses the role of market mechanism in resources allocation from Islamic economics angle. Let's assumed you are thinking about buying a new Laptop to assist you in your study. Now what and what do you need to plan successfully for this purchase? First of all you need to know various brands of laptops available in the market, you need information about their qualities and facilities to enable you buy the best among them, you also need to know the price of each brand, you also need to know where to buy the best brand at the least possible price. You will come to know that without the help of market mechanisms, you could not have all these information you required to plan your purchase successfully. This is also the same with the manufacturers of the laptops, without the help of market mechanisms, they could not manufacture the best laptop you like to purchase.

### **2.0 Objectives**

At the end of this unit, students are expected to understand:

- Meaning of market mechanism
- Islamic business ethics
- Different types of markets and their appraisal from Islamic economics
- Role of Islamic state in regulating market activities



### **3.0 Main content:**

#### **3.1 The meaning of market mechanism**

Market mechanism is the occurrence of transactions between sellers and buyers in a particular place which is due to the demand and supply factors (demand and supply). The market is the meeting of demand and supply for one type of goods or services. In the market, buyers and sellers mutually bargain to determine the price of various types of goods. In economic analysis, the notion of markets is not limited to a particular place but covers an area, country and even the international world. The market for rubber and tin, for example, is not intended as a place of sale and purchase of rubber or tin in a particular village or region but includes interactions between producers and buyers of rubber or tin in all corners of the world.

Markets where buyers and sellers interact can be divided into two types, namely the goods market and factor markets. The goods *market is a place where buyers and sellers of an item or service interact to determine the amount and price of goods or services that are traded.* On the other hand, the *factor market is a place where entrepreneurs (buyers of production factors) interact with owners of production factors to determine prices (income) and the number of factors of production that will be used to produce goods and services requested by the society.*

Islamic economic leaders explained that the market mechanism is not only determined by demand and supply factors. As Abu Yusuf said that there are factors that cannot be seen by humans, namely the factor of God's intervention in all things, including the market mechanism. Another matter was discussed by Ibn Taymiyyah who underlined that there might be a rise and fall in prices because of market players who are fair or can act unfairly. Of course this is contrary to the opinions of Western economists who focus on the market mechanism alone, namely the occurrence of up and down prices of pure goods because supply is lacking, so demand rises, or vice versa. So says Adam Smith, David Ricardo, or John Maynard Keynes.

Some of the goodness of market mechanism is that they can allocate factors of production quite efficiently and can encourage economic development because it has some good. The market can provide more precise information, the market encourages developing business activities, the market gives encouragement to obtain modern expertise, the market promotes the use of goods and factors of production efficiently, and the market gives high freedom to the community to carry out economic activities.

### **Self-Assessment Exercise**

Discuss the concept of market mechanism

### **Islamic Business Ethics**

Islam is a comprehensive religion that covers every aspects of human life. Below are the Islamic ethical behaviors to be observed in daily business transactions.

1. **Permissibility of lawful trade:** The Qur'an explicitly states that trade in itself is permissible "... but Allah has permitted trade and has forbidden interest" [Qur'an, 2:275]

2. **Prohibition of trading in "unlawful" items:** One basic rule in Islamic Law is that if an item is lawful, then buying or selling that item is also unlawful. Examples of that include trading in intoxicants, living off prostitution or other "immoral" activities, also trading in stolen goods. "Allah has made wine and its price unlawful, and made the dead animal and its price unlawful and made the swine and its price unlawful".

3. **Refraining from hiding any known defect in an item offered for sale.** The buyer should be informed about such defect [s] and it is up to him/her to accept to buy it or not and at what price. The Prophet taught: "The buyer and the seller have the option [to cancel or confirm the bargain. And if they spoke the truth and made clear [the defects of the goods], then they would be blessed in their bargain. And if they told lies and hid some defects, their bargain would be deprived of Allah's blessing" 34

4. **Honesty in all dealing is an ethical requirement,** including the fulfillment of all contracts, commitments and covenants. "And those who keep their trusts

and promises” [Qur’an, 23:8]. One aspect of honesty is to give the full weight and measure “Give full measure and do not be of those who cause loss [to others]. And weigh with an even [honest] balance” [Qur’an 26:181-182] “And give full measure when you measure, and weigh with an even [honest] balance. That is good and the better at the end” [Qur’an, 17:35]. The Qur’an warns those who violate this injunction: “Woe to those who give less [than due]. Who, when they take a measure from people [as buyers], they take in full. But if they give by measure or by weight [as sellers], they cause loss [to others by giving less than due]. Do they not think that they will be resurrected? For a momentous Day [the Day of Judgment]. The Day when mankind will stand before the Lord of the worlds?” [Qur’an, 83: 1-6]. The Prophet addressed the problem of cheating in more than one Hadeeth.. Following is an example: “Anyone who cheat us is not of us”

**5. Refraining from the exploitation of the ignorance or desperate needs of others** by giving them less than a fair price [or wage]. The Qur’an enjoins”...and do not deprive people of their due” [Qur’an, 7:85]. One form of that exploitation which the prophet forbade is “*Tanajush*”. This refers to deceptive practices in auctions, where persons who do not intend to buy simply keep bidding the price upwards [often in conspiracy with the seller], so as to get others “stuck” in the deal.

**6. Allowing the maximum possible “information”** about the going prices of good to be disseminated so as to allow the seller to get the best and fairest price for his goods. At the time of the Prophet, some middlemen used to go to the outskirts of the town [where there is a frequented market] where they intercept out-of-town merchants or farmers who are bringing their products to sell in the market. These middlemen would then offer to buy such products at a given price which was commonly less than the going market price. The Prophet forbade that practice and instructed that the sellers should be allowed to get to the market first [i.e. to find out the going or offered price for their products] before an offer is made to them. From an economist’s perspective, it is a case

of enhancing information among the buyers and sellers. This improves the competitive nature of the market and thus helps determine the “equilibrium” fair price.

**7. Prohibition of the sale of an item which is not available and whose delivery is doubtful [*Bay’ul-gharar*].** Examples of that include selling fish in the river or selling agricultural products before the plant becomes viable and takes roots. Exception to that is made for necessity, where fairness is ascertained.

**8. Restriction of unfair monopoly:** It may be argued that some “monopolies” may be more efficient and beneficial to society at large, such as the case of utilities, provided that proper controls and regulations are in place to prevent abuses. On the other hand, monopolies which are designed to create an artificially higher price or to create artificial shortages are forbidden. It is this type of monopolies that that the Prophet condemned, especially in respect to foodstuff “He who monopolizes is sinful”. “Whoever monopolizes foodstuff for forty days, he has dissociated himself from Allah and Allah has dissociated Himself from him”. The Prophet forbade also the practice where a town dweller withhold and store foodstuff that belongs to an desert dweller, wait until the price goes up [possibly due to this artificial shortage], then he sells that foodstuff [and thus get a higher commission] for his services.

**9. Ethical competition:** It is lawful for sellers to compete in order to attract buyers. However, attempting to “snatch” a customer who has already negotiated a deal with another seller is regarded as unethical, unless the earlier negotiation broke down or was cancelled for some other reason.

### **3.2 Different types of markets and their appraisal from Islamic economics**

**i) Free market system:** This is a type of market arrangement which placed blind believe on the mysteries of market forces to set equilibrium price that could clear the market without any shortage or overproduction. Profound by Adam Smith and championed by Fredman, this system discouraged any form of government intervention which, according to the system, is a distortion to the free interplay of market forces. It also assumed the existence of large

number of buyers and sellers who only take the equilibrium market price set by demand and supply of goods and services. However, this system failed to allocate resources efficiently because of the following weaknesses.

- The market produces and distributes goods and services that are not in accordance with the hierarchy of human needs but are comparable to the orders of individual purchasing power. The distribution of income and wealth is very uneven within and between countries, there is insufficient production of goods to meet all the basic needs of life - food, clothing and shelter - for the poor while luxurious for rich groups that are smaller is made abundantly. In other words, the allocation of resources is distorted. The economic idea of efficiency requires rethinking.
- The well-known marginal productivity theory does not distribute income according to the contribution of each factor to total output even if competition in the market is a perfect factor. Because, the demonstration that a factor is paid equal to the value of its marginal product to income does not in itself prove that the marginal product determines that payment because it is not a contribution of factors to output but its rarity relative to other factors that determine both marginal products and gifts. Remember also the Marshall dictum that the use of marginal and marginal costs does not determine value but is determined along with the value of the general strength of demand and supply.
- The market only provides personal items. Such items have two different characteristics: First, if one unit is purchased by A, the same unit cannot be purchased by B. This we call the exclusion principle. Second, if C uses commodities, D cannot use them simultaneously; For example, if I eat apples, you also can't eat them. We call this the competition principle. However, many items do not have exclusion or competition characteristics but people may need them. Non-excludability and non-rivalry can cause problems for the production of these items. . It is said that they can cause examples of market failure, because self-interest, the driving force of the system, may not allow their production in the

desired amount. These goods are provided by the government and are called public goods, the provision of civil administration or defense is a prime example.

**ii) Socialism:** This system tried to replace the free market system with the sophisticated planning organization, but the central planning institution created many problems. Socialism could not mobilize economic resources of socialist countries efficiently. The system could not produce viable solutions for the encountered social and economic problems created by bureaucratic orders. Today one of the main economic problems of our time is to take away the obstacles hindering free operation of the market institution. These obstacles are created either by bureaucratic monopolies in the Socialist System or by financial capital monopolies in the Capitalist System. Both of these monopolistic systems have created social, economic, and political problems at the national, regional and international levels, such as conflicts, unemployment and unjust income distribution. Foreign debts, interest mechanism and monopolistic tendencies are menacing not only internal but also international peace and solidarity.

### **Self-Assessment Exercise**

Explain the Islamic ethical behaviors in business

### **3.3 The Roles of Islamic State in Regulating Market Activities**

It is one of the essential duties of the state in Islamic economics to arrange a free functioning market for goods which have inverse relations between their amount and their marginal utility. These kinds of goods should be produced and marketed by the private individuals and firms. The state should not deal with production and trading of such goods. If it does so, it will prevent the free functioning of the market institution since the scarcity or abundance of these goods will be best reflected by the price level formed at the free market in accordance with the laws of supply and demand. It is not possible for private firms to compete with the organizations supported by the state. Monopolist interventions to the market limit the freedom of choice of sellers and buyers in

the decision-making process with their own will and consent. According to the main principles of Islamic economics, both sides of the transaction process should make their decisions with their own will and consent without any oppression.

According to Ibn Khaldūn, the state should not produce and trade goods for which prices are determined by the market. No any individual and firm can compete with the state in the market. He put forward that state administrators' involvement in trade activities will not benefit the state nor society. It will disrupt the economic balance and prevent competition, because nobody can compete with the state in buying and selling activities. The people who have the state authority can impose any price to sellers as well as to buyers. The state monopoly upsets operation of the law of supply and demand in the market. For these reasons, the state should not deal with trade activities to increase its revenues. If the state deals directly with trade or intervenes in trading activities, it may cause unfairness and upset social and economic balances. This kind of intervention will impoverish society. The direct dealing of the state in commercial activities does not enrich the state; in contrast, it will eventually lead to fall in national income and impoverish society.

Some goods and services have prices that cannot be formed by the market with the laws of supply and demand because there are no direct relations between their amount and their marginal utilities. These goods include medicines and roads, education and health services; they are called basic goods and infrastructure services. Such goods and services should be produced by foundations (*waqfs*) or public enterprises with a price which covers only their cost, because the demand for such products is not elastic. It is easy to establish monopoly in producing such goods. Inadequate production or high cost production of such goods and services may cause problems or economic imbalance.

**Role of Islamic state in the commodity market:** In the Islamic economic order the production and trading of commodities which have inverse relations between their amount and marginal utilities should be carried out by

individuals and firms. The state should not deal with the production and trading of such commodities. Commodity prices should be decided by the free operation of the commodity market according to the laws of supply and demand. It is one of the economic duties of the state to supply infrastructure services by public institutions and foundations (*waqfs*) for free functioning of the commodity market. However, state's roles in regulating the market in Islamic economic perspective are limited because the Prophet (PBUH) declined the request by his companions to set prices in the market.

**Role of state in the labor market:** in Islamic economics, it is an essential duty of society to meet the subsistence of needy members of society in Islamic economics. Otherwise the jobless person may be employed without his own will and consent. In such case, he will lose his ability of bargaining with his employer. It is essential for the owners of factors of production to realize production by their own will and consent according to oral or written agreements. Therefore, workers are theoretically accepted as participants; and compulsory employment of labor is prohibited. In an economic order based on this approach, the owners of factors of production will manage their firm jointly through their representatives. They will share output with joint decisions based on their free will and consent. The management of the firm will be based on consultation. The enterprise will be managed according to the parallel interest approach, not the conflicting interest approach. The jointly produced output will be shared justly among the participants.

#### **4.0 Conclusion**

Islam neither endorses nor condemns the free market system of capitalism but modifies it and emphasizes on state intervention whenever there is artificial distortion of free working of market mechanism. The Islamic state could not set the prices of goods and services in the market but could serve as a watchdog in the market for any possible maneuver or deception from the market participants. However, the Islamic system of market totally condemns the planning of market



and dictating prices by the central planning authority such as that of the socialist system.

### **5.0 Summary**

This unit discussed the market mechanism and shows that both free market system or what is generally known as perfect market competition and socialist system of market regulations have defects and weaknesses which prevents them from realizing their strategic goals. The Islamic system of market mechanism put more emphasis on supervised interplay of market forces of demand and supply in order to avoid market participants from distorting the free working the system.

### **6.0 Tutor marked-assignment**

- 1) What do you understand by market mechanism?
- 2) Explain the Islamic ethical behaviors in daily business transactions
- 3) Discuss the roles of Islamic state in regulating market activities.

### **7.0 References/Further readings**

. Yasin, H. M. and Khan, A. Z. (2016) “Fundamentals of Islamic Economic and Finance”, Islamic Research and Training institute, Jeddah, Saudi Arabia.

Faidatun, N. (2019), Market mechanisms in conventional economics and Islamic Economics.

## **UNIT THREE: Islamic Macroeconomics, Fiscal and Monetary Policy**

Contents:

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Contents
  - 3.1 Islamic macroeconomic objectives
  - 3.2 Fiscal policy in Islamic Economics
  - 3.3 Monetary policy in Islamic Economics
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor marked-assignment
- 7.0 References/Further readings

### **1.0 Introduction**

Macroeconomics is the study of aggregates economic variables such as aggregate demand, aggregate supply, employment level, output level, national income, etc. Aggregate economic variable is the summation of all units of such variable in the economy. Islamic economics is not left out in discussing the behavior and determinants of such aggregate variables in the economy. However, Islamic economics' approach to these aggregate variables is entirely different from the conventional economics because it inputted Islamic principles in its analysis. This unit discusses macroeconomic analysis in Islamic perspectives with special reference to fiscal and monetary policy of Islamic economy.

### **2.0 Objectives**

At the end of this unit students are expected to understand:

- Objectives of Islamic macroeconomics
- Fiscal policy in Islamic economics
- Monetary policy in Islamic economics

### **3.0 Main content**

#### **3.1 Objectives of Islamic macroeconomics**

1) Social justice and equity: In line with the injunctions of Shari'ah, each citizen in the Islamic state should be treated fairly and equitably. Islamic macroeconomic policy instruments should guarantee access to economic

resources, opportunities vital information, etc. to all regardless of their background, color or race.

2) Provision of socioeconomic needs of the society: The Islamic state should use its macroeconomic policy instruments to provide and sustain social and economic infrastructures, in other words, called the social overhead capital (SOC) for promotion of economic activities and welfare in the state. Education, health, security, electricity supply, roads, communication, etc. are critical for social economic progress of any modern state and in which case, Islamic state is not an exception. Provision of these services would not only free access to economic resources but also trajectories the economy along the path of greater economic prosperity.

3) Enhancement of the community's economic resources or growth: An Islamic state should aim to increase national output over time using its macroeconomic policy instruments. Through efficient utilization of God-given resource as well as formulating goal-oriented policies, Islamic state can put its economy on the path of economic growth and development.

4) Economic stability: Islamic state also aimed at achieving and sustaining economic stability both in the short run and in the long run. Although business cycles in economic activities are natural and beyond human control, however, Islamic state should try to strategize preventive plans and policies to minimize the hardships in the recession periods.

5) Full employment without inflation: First of all, employment is a means to an end, not the end by itself. Secondly, with constraints emerging from the principles of no *riba* and no *qimar* will have two implications. First, real and financial sectors in the economy will be integrated. And, financial bubbles will not be created that are important cause of inflation and business cycles. Second, economic exchanges beneficial to only one party will be pushed into the background. Both these factors will encourage production and employment, and lessen chances of inflation.

### **Self-Assessment Exercise**

Discuss the basic objectives of Islamic macroeconomics

### **3.2 Fiscal Policy in Islamic Economy**

Fiscal policy can be seen as an instrument through which an Islamic state makes use of its income, expenditure, taxation and borrowing power to achieve positive effects on the economy. In other words, it is the use of government revenues and expenditures to control the economic activities in a state. It has also been defined by Monzer Kahf as the set of laws, regulations, instructions, procedures and process related to structuring and collecting public revenues, determining and spending public expenditures, public/surplus and its management and the public budget.

There are two types of fiscal policy which includes; expansionary and discretionary fiscal policy. The first type relates to the deliberate attempts by the Islamic government to raise the level of its spending, lowering the level of taxes or increasing the level of government borrowing in order to achieve positive effect on the economy; economic growth and development, full employment, equitable distribution of income, price stability, etc. while the second one is reverse approach of the first one. That is cutting down government spending, increasing taxes or reducing government borrowing to achieve desired macroeconomic objectives.

#### **Instruments of Islamic Fiscal Policy:**

Instruments of fiscal policy in Islamic state are; (1) government spending, (2) taxation (3) public borrowing. We discuss them one after another in conjunction with Islamic law or Shari'ah.

##### **1) Government Spending;**

Government spending is one of the ways through which an Islamic state could directly stabilize the economy. The level and composition, which usually is presented through annual budget, has serious implications on the economy. Less government spending means less employment opportunities for under employed resources and therefore less economic prosperity and vice versa. In Islamic economy, public wealth cannot be wasted in lavish and extravagant spending as envisaged by the second Caliph of Abbassid who said that *“public money should not be spent on lavish consumption but it should be spent to*

*provide defense, security, improving the living standards of the people by provision of accommodation, necessary amenities and safeguarding their souls and properties.*

It is also the responsibilities of Islamic state to provide employment opportunities to the people and protects their wealth from erosion by curbing inflation. For instance, if the prices of goods and services continue to rise in the Islamic state, it is an indication that the purchasing power of individuals is too high and the government needs to cut down its spending which would have a reverse multiplier effect on income and consumptions of the individuals.

As pointed out by Islamic economists, Islamic government expenditure can be categorized into permanent and necessary expenditures. The permanent expenditures include;

- Defense,
- Law and order,
- Justice,
- Provision of basic necessities,
- Propagation of Islam,
- Enjoying good and forbidden evils,
- Civil administration and
- Social sector

While the necessary expenditures include:

- Environmental safeguard
- Necessary goods listed in the first schedule
- Scientific research
- Capital formation and economic progress
- Subsidies for important activities/ private activities
- Cost of achieving economic stability
- Expenditure for additional activities assigned to the state by the people

**Basic principles guiding public expenditure in Islamic state**

i) **Principle of achieving the objectives of Shari'ah:** This principle entails that Islamic government spending should be coined and directed towards realizing the objectives of Shari'ah such as protection of life, religion, intellect, family tiers and wealth.

ii) **Principle of public welfare:** This principle maintained that public spending in Islamic state should be for the improvement of general well-being of the society regardless of region, sector social status. It should emphasize in this principle that the Zakat wealth must be spent on only eight categories of people mentioned in the Holy Qur'an.

iii) **Principle of justice:** Islam attached high importance and recognition to the principle of justice in all spheres of Muslims life. Therefore, all resources should be justly spent and equitably distributed among all individuals and classes without any discrimination. Allah the exalted said in the holy Qur'an *“Oh Muslims, Allah enjoys you to give the trust unto the care of those persons who are worthy of trust, and to judge with justice when you judge between people. Excellent is the counsel that Allah gives you, for Allah hears everything and sees everything”* (Q4:58).

iv) **Principle of safeguarding the right of future generation:** Islamic government should have a foresight and plan for the future generation by preserving some resources and convert them into productive capital resources. It is not enough for an Islamic state to provide abundantly for wellbeing of present generation at the detriment of future generation. It should guarantee and make adequate provision and allocate resources for them and prevent erosion in the value of their share of the resources. For instance, it was reported that Umar (R.A.) declined the request to distribute the conquered land of Iraq and Syria to the soldiers and instead, he said: *“Do you want that nothing should be left for the future generations?”*

v) **Principle of balance development:** This principle demands Islamic government to allocate and spread economic resources in such a way that all sections and regions of the society benefits from the resources and develop evenly.

**2) Taxation:** taxation in Islamic state is levied in order to redistribute income equitably among its indigenes. This can be justified on the ground of the rationale behind imposing Zakat collection from the rich Muslims who have twenty *Dinars* (Gold) or its monetary equivalent and above to be distributed to the eight categories of people mostly poor and the destitute. During the early history of Islamic state, *zakah* was the only Islamic fiscal duty of the state. A poll tax *Jizyah* was only levied on non-Muslims under the protection of Islamic state. Also, Caliph Umar (R.A.) introduced *kharaj* which is a tax levied on fertile land owned by non-Muslims in the conquered areas ruled by Islamic government. Other forms of tax includes: land tax, sales tax, excise tax, export duties and import tariffs, fees from government services, etc.

Unlike *Zakah*, taxes can be varied from time to time and can be spent on a variety of projects to impact on the economy and control business cycles. For instance, if there is unemployment in the economy due low productive activities, tax rate can be lowered to to encourage investment which would provide employment opportunities to the people.

Also, *Zakah* has some economic implications that could be used to stabilize the economy. Below are the implications of *Zakah* on the economy.

**a) Incentive to produce:** *Zakah* can be used to stimulate production by increasing the level of aggregate demand because majority of *Zakah* beneficiaries are poor and needy who have high marginal propensity to consume (MPC).

**b) Incentive to consume:** Poor people have low purchasing power with high MPC. Giving *zakah* proceeds to them will increase their consumption and promote their welfare.

**c) Incentive to invest:** *Zakah* is imposing on wealth that reaches *nisab* weather it is increasing through investment or decreasing. Therefore in order not to allow erosion of wealth because of annual *zakah* payment, the wealth has to be invested to generate profit.

Other economic implications of *zakah* includes; incentive to work, redistribution of income, control of business cycles.

**3) Public Borrowing:** This is another instrument of fiscal policy in Islamic state which refers to the voluntary transfer of fund from one government to another. That is from lender or creditor to a borrower or debtor. Public borrowing is one of the important measures usually taken by governments to finance its budget deficits which emerge as a result of gap between public revenues and expenditures. Islamic government can finance its budget deficits by issuing non-interest bearing *sukuk* in the Islamic capital markets.

Historically, Siddiqi in his paper “Public Borrowing in the Early Islamic History” documents up to seven cases of borrowing by the Holy Prophet (S.A.W.). The loans were in both cash and kind and were meant to cater for the financial needs of less privileged and defense. Also, several cases of public borrowing continued to be attributed to Muslims states. This includes Abbasid governments, Ottomans and the modern Muslims economies since the middle of the nineteenth century.

#### **Self-Assessment Exercise**

Discuss the major distinguishing features of Islamic fiscal policy

#### **3.3 Monetary Policy in Islamic Economy:**

Monetary policy is the alterations of the quantity of money in circulation to achieve desired macroeconomic objectives. In time of economic recession, injecting more money into the economy would make financial resources available for investment and consumption at a lower cost. In the same vein, withdrawing money from the economy at the time of inflation would make financial resources costly and inaccessible which would reduce purchasing power and consequently curtail inflation.

In conventional economic system, all these alterations of quantity of money in circulation are carried out on the basis of interest which is vehemently condemned by Islamic law. However, in Islamic economics, these alterations are done on the basis of profit and loss sharing arrangements and benevolent loan, *Qard-Hassan*.



## **Instruments of Islamic Monetary Policy**

As noted earlier, charging of interest is not allowed in Islamic finance and therefore, conventional monetary policy instruments which will have nothing to do with interest must be available to meet the goals of Islamic economy. Also, these instruments must help to regulate money supply in harmony with the real demand for money as well as help to fulfill the genuine need for government deficits financing, which seek to achieve the realization of Islamic socioeconomic goals for development and progress of the society.

Islamic economists identified the following monetary instruments as relevant and applicable to an Islamic economy:

- 1) Profit and Loss Sharing (PLS) ratio
- 2) Lending ratio
- 3) Demand deposit ratio
- 4) Refinance ratio/Equity based instruments
- 5) Open market operations
- 6) Statutory reserve requirement
- 7) Credit rationing/ceilings
- 8) Regulation of the high powered money
- 9) Moral suasion

Detail explanations of these instruments are provided as follows:

**1) Profit and Loss Sharing (PLS) ratio:** It is also known as the *Mudarabah* ratio. It is the ratio which is used to distribute profit between the bank borrower/entrepreneur on the one hand and between bank and depositor on the other. It is potentially meant to perform the same role like interest rate in conventional economy. It stands as the basis on which *Mudarabah* investments are to be conducted between the banks and their customers. In view of interest prohibition in Islamic economy, capital contributor would only be entitled to profit. Thus, a high ratio to the entrepreneur implies low share to the bank, which has the economic implication of encouraging investment and more money available to the people. Figure D below explain this scenario.

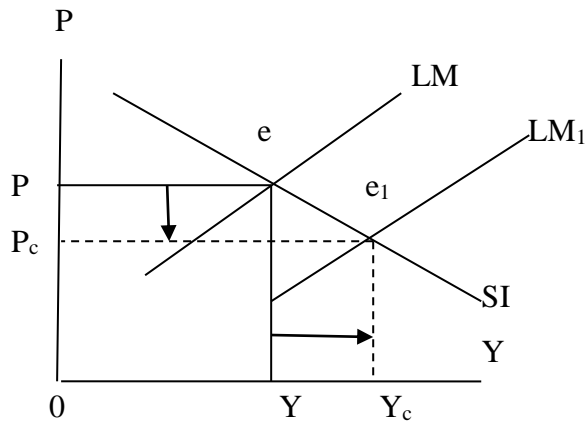


Figure D: Expansionary Monetary Policy in an Islamic Economics Framework

From the figure above, the vertical axis  $P$  represent profit rate or rate of return and the horizontal axis  $Y$  represent income level in the economy. The IS-LM model shows how reduction of profit rate from  $P$  to  $P_c$  increases the economy's income from  $Y$  to  $Y_c$ . In an expansionary monetary policy, an increase in the supply of high-powered money will shift the LM curve outwards to  $LM_1$  and this lowers  $P$  to  $P_c$  which causes decrease in the level of income available to people. On the other hand, a fall in  $P$  will encourage and stimulate more investment in the economy because more money would be available to investors.

**2) Lending Ratio:** This is the percentage of benevolence loan or *Qard-Hassan* which the Islamic commercial banks are expected to lend to target group free of charge. The popular view among scholars and Muslims economists is that part of demand deposits of commercial banks should be made available to the poor and needy free of charge. This ratio is peculiar to Islamic banking system that has implication of increasing the purchasing power of the poor people, who are the majority in the society, which will in turn increase effective demand at macro level.

**3) Demand deposits Ratio (DDR):** This is part of the *Qard-Hassan* or demand deposits of the commercial banks which is made available to the government for the purpose of financing socially profitable and beneficial projects in the areas where commercial banks financing is not feasible or desirable. This fund is provided to the government in form of loan which, according to Islamic economists, must not exceed 25% of the total deposits. This percentage is justified on the ground that; commercial

banks acts as agents of the public in mobilizing idle resources in the economy, commercial banks do not need to pay any returns on these deposits and the public does not bear any risk on these deposits.

**4) Refinance Ratio/Equity base:** This ratio means the provision of liquidity to the commercial banks in times of needs by the lender of last resort. The percentage of refinancing ratio should be proportional to the percentage lent out by the commercial banks free of charge. In order to reduce money in circulation, refinance ratio would be lowered and vice versa.

**5) Open Market Operation (OMO):** This instrument is the most popular in conventional finance which involves direct manipulation of interest rate and indirect manipulation of money supply. However, since Islamic economy is an interest-free economy, Islamic economists like Khan (1982) and Siddiqi (1982) posit that OMO could still be operational with securities that are interest-free or do not bear fixed rate of return. Hence, the sale and purchase of equity-based shares like *Mudarabah/Musharakah* certificates have been suggested as replacement. Therefore, to curtail inflationary pressure in the economy, government can sell these certificates to the public which will enable them to participate in the investment opportunities available in the economy. Also, to boost production activities, government can purchase the securities from the public which will make investments fund available in the economy.

**6) Statutory reserve requirement:** This is a central bank's requirement on the part of commercial banks to keep certain percentage of their demand deposit as statutory reserves with the central bank. This is done in order to ensure safety and liquidity of the banking sector. The reserve ratio can be increase or decrease in order to control the quantum of money in circulation.

**7) Credit rationing/ceilings:** This is a policy of the central bank which is used to allocate credit evenly among the different sectors of the economy in accordance with the target of monetary policy. This policy is important in less develop economies such as Muslims state where imbalances in the rate of growth of the sectors or industries occurred.

**8) Regulation of High-powered money:** This is the monetary base of the economy which includes the currency in circulation plus deposits at the central bank. Thus, one of the functions of the central bank in Islamic state is to ensure that the desired growth in the money supply (M) and the supply of high-powered money ( $M_0$ ) are consistent

with the growth in the real sector of the economy. This is to support the growth process of the economy and to curtail inflationary pressure.

**9) Moral Suasion:** This refers to the informal methods of controlling commercial banks to comply with central banks directives. It includes advices, persuasion, mutual consultations, interactions and meetings with commercial banks and the public to enlighten them on the positions of the central banks on various issues in the economy. In fact, this instrument is expected to play more roles in policy formulation and implementation of an Islamic economy because of its value laden orientation and philosophy. This policy process is necessary and useful for commercial banks with respect to the size, nature and direction of their loans, *Mudarabah* and other equity financing.

#### **Self-Assessment Exercise**

Differentiates between Islamic and conventional monetary policies

#### **4.0 Conclusion:**

Islamic economy is structured and organized with built-in stabilizers which can be used alternatively to adjust and control economic and business fluctuations. These stabilizers are not available in conventional economies and this mark a major difference between Islamic economics and its conventional counterparts. For instance, zakah is peculiar to Islamic economics and can be used to boost production activities during recession by distributing it directly to its beneficiaries who have high marginal propensity to consume. In case of inflationary pressure, taxes can be increased and zakah can be distributed in forms of zakah shares certificates. This will reduce money in circulation and increase investment activities.

#### **5.0 Summary:**

This unit discusses the nature of Islamic macroeconomics which is the study aggregates economic variables with the main aim of achieving socioeconomic justice and equitable distribution of income as well as general wellbeing of the society. It also discussed fiscal and monetary policies of an Islamic economy and shows areas of fundamental difference between Islamic fiscal and monetary policies and its conventional counterpart.

#### **6.0 Tutor marked-assignments**

- (1) Discuss the nature of Islamic macroeconomics
- (2) Discuss the distinguishing features of Islamic fiscal policy
- (3) Differentiates between Islamic and conventional monetary policies

## **7.0 References/Further readings**

Yasin, H. M. and Khan, A. Z. (2016) “Fundamentals of Islamic Economic and Finance”, Islamic Research and Training institute, Jeddah, Saudi Arabia.

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## **MODULE FOUR: INTRODUCTION TO ISLAMIC WELFARE**

### **UNIT 1: Appraisal of Conventional Welfare Theory**

1.0 Introduction

2.0 Objectives

3.0 Main Content

3.1 Concept of Welfare

3.2 Difference between Islamic and Conventional Welfare

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further readings

#### **1.0 Introduction**

Despite the development of economics as a science there is no consensus on the issue of welfare of an individual or the society. Different approaches and explanations have been offered on this, yet, there are divergent views. The point of contention is whether the welfare of an individual is left in the public or private sector. Even if it is measurable it is achievable or remains idealistic concept. These and many more are the subject of this unit. It specifically provides alternative view from Islamic perspective.

#### **2.0 Objectives**

The objectives of this unit include

- i. To expose students to western conception of welfare and theories
- ii. To enable students appraise the concept of welfare theory
- iii. To provide alternative view on welfare theory from Islamic perspective

#### **3.0 Main contents**

##### **3.1 Concept of welfare**

Welfare refers to an improvement in the living condition of a person or an economic agent. It may be provided by the market or the government depending on the economic system and situation at hand.

As usual, economists assume that the market will distribute returns to factors of production fairly. Traditionally growth theories focus on the Kaldor-Kuznets

stylised facts. There are however arguments by Ravikanbur and Joes Stiglitz that competitive marginal productivity theories for factor returns have to be dropped in favor of rent-generating mechanism and wealth inequality by focusing on “rules of the game.” The new models would also capture interactions among physical, financial and human capital as well as mechanism that transmit inequality from generation to generation. It is indeed a breakthrough that leading economists recognise the normative questions in economics analysis. That is the question of inequality in outcome or in opportunity as examples. Even in socialism the issue of distribution have not succeeded in resolving inequality though it is at the centre of it. For instance, the value of human labor did not attract fair returns across individuals in the society neither do the bourgeois give way to the proletariat so that justice would be ensured.

Thus, the distribution of income and productive resources remain largely skewed and economic system distinguishes itself for one another on the basis of distribution. Thought there is no consensus on distribution mechanism there is one on the need for fairness and justice. However, what is fair and justice may not be the same across societies. According to mainstream economics, factor prices are determined by market forces and are just and efficient. This means that transfers are allocated optimally towards alternative ends and distribution is just and fair. However, efficient does not ensure equity.

### **3.2 Differences between Islamic and Conventional Welfare**

The philosophical underpinning of neoclassical economics on man being a product of nature (not creature) is departing point between Islamic economics welfare and conventional counterpart. In addition taking humanity as the ultimate reality and perfectibility of human being even without superhuman aid make it completely contradictory to Islamic philosophy of Economics.

Ana Zarka summarises western conception of man in four principles as i) hedonism who derives pleasure-pain principle of Jeremy Bentham ii) Rationalism which is the means-end orientation or the use of deliberate choice

among alternatives in seeking satisfaction of man`s wants. Iii) Individualism/Atomism-which is the assertion of the essential separateness and autonomy of each man from every other and iv) freedom-which holds the assertion that man initially is totally free. His limitation stems from his socialization with others who are equally free.

To understand some of these conceptions further, E Shil elaborates on the hedonistic attitude as “an obligation of government to support progressive populist hedonism...All or most members of a given national society should be gratified in their material wants and this gratification should be continuously extended. The goal is a continuous increase in the supply of products available for the gratification of needs. S. F Singer (1971) also defines quality of life as a situation where material comforts are important and contribute to what people perceive as happiness, a loose definition (of the quality of life) might be having as much as money as possible left over after taking care of the basic necessities and having the necessary time and opportunities for spending in a pleasant way.”

Economists assume that the consumer is primarily motivated by the desire for personal consumption and leisure and it is further assumed the desire is insatiable thus he continues satisfying it in a rational way to maximum point. All other non-economic factors are treated as exogenous. This weak assumption limits the power of economists to analyse realistically human behaviour.

### **3.3 An Islamic Social Welfare Function**

Muslim thinkers long before Adam Smith, Jeremy Bentham and Karl Marx have written extensively on the Islamic social welfare function. Imam al-Ghazali (died 505H) formulated this and refined by Imam al-Shatibi (died 790H). The beginning of their conception is determining the goals for human life. According to Zarka (2011) all matters (be they activities or things) that help in achieving these goals increase social welfare and are called *masalih* or utilities, the opposite are *mafasid* or disutilities. According to al-Ghazali and



al-Shatibi the social utilities may be divided into three levels: i) Necessities ii) Conveniences and iii) Refinements.

I) **Necessities:** These comprise all activities and things that are essential to the preservation of the five foundations of good individual and social life vis-a-vis protections of religion, life, intellect, progeny and wealth. The examples of each of these aspects are not far-fetched. For instance, I) establishment of the five pillars of Islam ii) inviolability of human life and related sanctions, the permission to earn a living, to eat to drink iii) prohibition of alcohol and other drugs that attack mind and pollute it iv) The institution of marriage and the prohibition of fornication v) protection of wealth, prohibition of its destruction, prohibition of transgression against the property of others among others.

II) **Convenience:** These comprise all activities that are not vital to the preservation of the five foundations but rather are needed to relieve or remove impediments and difficulties in life (Zarka, 2011).

Examples of this include the use and enjoyment of things that man can do without e.g the use of blanket during cold weather condition, use of public transportation for a short distance journey instead of walking or carrying loads on one's head when he can get a truck to transport it for him. Equally convenience also includes activities and things that help to promote and develop rather than preserve the foundations eg printing of books that promote some necessities like daawa. Similarly, protection of health and promotion of physical education to strengthen body and acquiring knowledge, promoting education and developing wealth both public and private to the extent required for the achievement of conveniences.

III) **Refinements:** These comprise all activities and things that go beyond the limits of conveniences. It include things that complement, brighten or adorn life not those that remove or relieve hardships. Some of the characteristics of this category include moderation in general and a particular of which is moderation in expenditure. Allah says ..neither prodigal nor parsimonious but moderate between” (25:67). Improving the quality of one's work and

productivity as the Prophet s.a.w says Allah loves for one of you, if you do a job, to do it perfectly.”

Other qualities include politeness in behaviours and speech, observance of Islamic etiquette in eating, drinking, clothing, salutation cleanliness, rest, innocent hobbies, recreation and kindred activities in amounts adequate to provide rest for body and mind and to restore one`s energies. However, exceeding refinements to prodigality and self-indulgence is a dis-utility for individuals and society thus must be avoided.

In view of this, Jamaladdee al-Atiyyah reclassifies the three levels into five by adding one at the top and one at the bottom. According to him there is also what falls short of necessity as in period of war and crisis. This can be observed among Internally Displaced Persons and immigrants of crisis. They can go to the extent of eating what is quite unhealthy or non-legitimate as provided in the sharia. So for this category they need special intervention to support them to raise their status at least to the minimum. The fifth category to Atiyyah is what exceeds beyond refinements. Example of this is flamboyant and luxury life of some people even though the societal scarce resources are not well utilised as many are in dire need of same resources. There is *tabdhir* which is using the resources in non-sharia compliant activities or items like in alcohol consumption or gambling and there is *israf* which is extravagant in what is initially permitted such as in wedding ceremonies.

Thus, the set of objectives of Islam as stated by al-Ghazali and al-Shatibi for man and society, attainment of these objectives increases social welfare. Unlike various approaches of managing welfare of a society such as Pareto Optimality by Vilfredo Pareto, the greatest benefit to the greatest number by Jeremy Bentham, these objectives are clear, universal and practicable not only for individuals but also for the general society.

#### **4. Conclusion**

There are exists several theories of welfare in the history of economics. It is clearly demonstrated that those welfare theorist that focus on either government

alone or private sector solutions are not sustainable and bound to be lost in the application. However, Islamic alternative to welfare tend to be more realistic and holistic in its approach and universal for human consumption not only among Muslims.

## **5.0 Summary**

The unit presents welfare as an improvement in the living condition of a person or an economic agent. The effective welfare provision is a collective responsibility by the society and its members.

It was demonstrated that that theorist that proposed welfare theory were not able to combine the two measures required by the society. I.e equity and efficiency. An Islamic alternative view was presented which is based three levels of human needs, a theory developed by al-Ghazalia nd refined by al-Shatibi.

## **6.0 Tutor-Marked Assignment**

Explain the Concept welfare

Critically appraise mainstream welfare theories and their assumptions.

Discuss level of needs in relation to individual and societal welfare.

## **7.0 References/Further readings**

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## **UNIT TWO: DISTRIBUTION IN ISLAMIC ECONOMICS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Goals of Distribution in Islamic Economics
  - 3.2 Functional Distribution in Islamic Economics
  - 3.3 Personal Distribution of Income
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further readings

### **1.0 Introduction**

Distribution is one of the key aspects though neglected in mainstream economics. It is initially treated as purely market based. Thus, resources are shared among those who participated in the production. The market will then determine their values and distribute accordingly. To Mark, the post production distribution by market system is unfair and time bomb because workers are exploited by non-working capitalists. They accumulate what they refer as profit, which according to him is congealed labor.

### **2.0 Objectives**

- I. To describe the objectives of distribution in Islamic Economics
- Ii. To analyse the phases of production in relation to distribution
- Iii. To show the differences between Islamic and conventional economics in distribution

### **3.0 Main Contents**

#### **3.1 Goals of Distribution in Islamic Economics**

Islamic economics emphasises the fair distribution of wealth and resources in the society. Man is created in the best mould, is the khalifah on earth (2:30). Man is meant to support one another in life.

The primary goals in Islamic economics as identified by Munawar Iqbal:

i. Guarantee of Fulfilment of Basic Needs based on Qur'an and Hadith, i.e. on objectives of sharia (maqasid al-shari'ah), non-obligatory (fard kifayah). However to fulfil these needs, voluntary, compulsory and state measures used. These may differ from society to society depending on the level of development, culture and natural environment.

ii. Equitable Distribution of Wealth and Income.

This ensures that wealth and resources are not concentrated in the hands of few individuals

iii. Elimination of extreme inequality: Man is endowed with different capabilities which represent natural inequality. This may result in inequality in earnings which is natural as well. However, wealth is a test (6:165).

iv. Economic power. It is also essential to possess economic power so that one will be maintain dignity in life at individual and societal level.

iv. Producing surplus of income to achieve non-economic social duties.

vi) Reduction not elimination of inequality.

### **3.2 Functional Distribution**

There are basically four factors of production in mainstream economics vis-a-vis land, labor, capital and entrepreneur. The distribution of income is based on the accrued rent, interest, wages and profit to the respective factors above. The reward of the factors except entrepreneur is determined by the market forces and known as apriori while the reward of the entrepreneur is post-determined as residual. The labor seems to be the weakest compared to rest other factors thus become more volatile.

In Islamic economic system makes a distinction between physical and financial capital. The system accepts predetermined reward for physical capital (rents) but rejects accrual of such rewards (interest) for financial capital. In the system, financial capital is considered as an integral part of the entrepreneurs thus liable to bear the risk and uncertainties of the business. It recognises only a variable reward for the entrepreneur and owner of the financial capital which

may be positive, zero or negative by the end of the activity concerned (Yasin, and Khan, 2016,p. 153).

Yasin and Khan (2016) evaluated the framework of Marginal productivity theory where  $Y=f(L,K)$   $MPI= dy/dl$  greater than 0,  $MPk=dy/dk$  greater than 0,  $MPk/MPI=r/w$ .

According to them;

A) It is difficult to measure marginal productivity of an individual since products is the result of joint effort

B) The theory is founded on weak assumptions and questionable. For instance, different factors may not be homogeneous and may not be easily be substitutable

C) The theory is based on the assumption of perfect competition in the factor markets which may not be realised.

D) There is ambiguity in the theory. The reward for factors are determined in the respective markets not by the marginal products as suggested by the theory.

### **3.2 Personal Distribution of Income and Wealth**

This refers to the total income accrued to by the household other than transfer receipts in a period of time. Since functional distribution depends on the asset endowments it does not hold that the income to person across individuals will be fair and efficient. More so, if the individual is sick or unemployed he gets nothing from the system. However, the needs of an individual will remain and the persons either to find another means of satisfying them or starve to death in case of foods and drinks. This is where the question of equity comes in. In mainstream economics, justice has not been done to the issue of fair distribution but rather shifted to sociology and political science.

The issue of poverty and inequality has however takes a front stage recently among policy makers and academics though the approach is still weak. Poverty is the inability of a person or household to fulfil his/her basic needs. Income

inequality however is the existence of a wide gap between haves and have-nots in the society. This duo co-exists throughout human civilizations but their manifestations change depending on situation and circumstances. Poverty is usually measured by income. According to United Nations, one is poor if he could earn 1.9 USD per day.

Inequality is however measured by Gini coefficient which is a value between 0 and 1. The closer the value to zero the better the income distribution to the society. In other words, 1 means perfect income inequality whereby all resources are in the hand of one person while 0 means perfect equality.

Islam offers the most complete and comprehensive approach to distribution of income. According to Sayyid Tahir (2003) the distribution in Islam is addressed as follows:

- A) Opportunity level-Preproduction stage
- B) Production level-which may be divided into two i) distribution among the participants in the process ii) redistribution among non-participants to poor and destitute
- C) Post-Production level-fulfilment of sharia justified minimum needs.
- D) Annual redistribution through implementation of zakat
- E) Intergenerational redistribution through the law of inheritance.



## **UNIT THREE: REDISTRIBUTION IN ISLAMIC ECONOMICS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Concept of Zakat
  - 3.2 Concept of Waqf
  - 3.3 Inheritance
  - 3.4 Concepts of Sadaqat, Inheritance and Gift
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further readings

### **1.0 Introduction**

Islamic economic system is a unique system that promotes wealth sharing against wealth concentration. This wealth can be shared through fair trading, equitable transfer of wealth and income, redistributive schemes such as zakat and sadaqat among others. The system thought discourage laziness, begging, and sharp practices, it however, mandate obligatory and voluntary charities among Muslims. This is to ensure social security and safety net for all. The zakat, which is the third pillar of Islam is proven to be a catalyst for reducing wealth disparity among Muslims in the past and in the present. During Umar bin Abdulaziz there was no body to be given zakat because of the blessings put in the system. Recently, some countries as would be presented below demonstrate the potentials of zakat and its impact in reducing poverty in the society. Similarly, other charitable deeds such as waqf, sadaqah and inheritance were discussed in this unit.

### **2.0 Objectives**

At the end of this unit, students are expected to understand:

- The concept of Zakah
- The concept of Waqf
- The concept of Sadaqah, Inheritance and Gift

### **3.0 Main Contents**

#### **3.1 The concept of Zakat**

Zakat literally means purification. Technically it is an amount given by a Muslim rich who possesses the minimum threshold to the identified categories of recipients as mentioned in Quran 9:60. Zakat is associated with salat in more than 30 verses of the Quran. It is the third pillar of Islam which represents economic aspect of Islam. Zakat encourages pursuing economic activities in various sectors of the economy such as trade, agriculture, industry, and services. Thus, emphasis is not only on taking zakat from rich but making the rich to invest more and generate legitimate profits and grow their wealth. Impliedly, zakat will not only eat up the non-invested wealth but will also increase the zakat proceeds thereby alleviating the sufferings of the poor and other beneficiaries. Allah says in the Qur`an *“take, (O Muhammad), from their wealth a charity by which you purify them and cause them increase and invoke (Allah’s blessings) upon them. Indeed, your invocations are reassurance for them. And Allah is Hearing and Knowing”*Q:(9:103). This verse clearly shows the various significance of zakat in terms of worship; administrating and the inherent blessings that come with it. The Prophet pbuh says *“Take wealth from the rich and turn it over to the poor.”* Allah’s messenger sent Muadh to Yemen he said to him *“invite the people to testify that none has the right to be worshipped but Allah and I am Allah’s apostle. If they obey you to do so, and then teach them that Allah has enjoined on them five prayers in every day and night. If they obey you to do so, then teach them that Allah has made it obligatory for them to pay the alms (Zakah) from their property which is to be taken from the wealthy among them and given to the poor”*(Ibn Abbas).

#### **Types of Zakat**

Broadly there are two types of zakat i.e. zakat al amwal and zakat al fitrah. While for the later, a Muslim is required to pay certain amount of food at the end of Ramadan, before the eid, zakat al mal includes items of trade, gold and silver, farm goods, mining goods, marine goods, livestock, founded treasure

and income of professionals. It is also paid annually by Muslims who possess *nisab* in addition to other conditions that have to be fulfilled.

**The conditions of zakat include:**

- a) being a Muslim male or female
- b) possessing an amount of wealth equal to or exceeding the prescribed amount (Nisab)
- c) to pay at the passage of a year of ownership of such wealth a prescribed rate/portion to specifically designated eight categories of people enlisted in the holy Qur'an.

**Beneficiaries of Zakat**

Quran 9:60 clearly states the eight beneficiaries of zakat as follows:

*“Zakah expenditures are only for the poor and for the needy and for those employed to collect [zakah] and for bringing hearts together [for Islam] and for freeing captives [or slaves] and for those in debt and for the cause of Allah and for the [stranded] traveler - an obligation [imposed] by Allah . And Allah is Knowing and Wise.”*

**Significance of Zakat in the Society**

Firstly, it plants loves and cooperation between the haves and have not members of the society. Through the payment of zakat, the poor is felt loved by the rich and the potential hatred is eliminated in the process replaced by caring and cooperation. The poor will now pray for the rich and the blessings continue to manifest in the society.

Secondly, payment of zakat reduces the unwanted wealth concentration among the few riches in the society, thereby bridging the gap between the rich and the poor. This way, coupled with the multiplier effect of private spending, trade and commerce will be advanced and economic prosperity will be resulted. Allah says in the Qur'an "...so that wealth will not circulate among few riches among yourselves" (Q: 59: 7).

Thirdly, there will be smoothening consumption and regulating, if not eliminating the cyclical effects of business cycle. This is more realizable where institutional zakat collection and distribution is advocated such as in the South East Asian countries. Yusoff (2009) views that zakat can be used as a fiscal measure to control recession or to boost the economy. Thus, expansionary zakat policy would be applied during recession while contractionary zakat policy would be adopted in the boom period.

Fourthly, zakat is a reliable means of eradicating poverty. Zakah System provides permanent mechanism from within the economy to continuously transfer income from the rich to the poor and that once correctly assessed, promptly collected and properly disbursed, it plays the role of solving dangerous problems such as poverty, unemployment, catastrophe, indebtedness, drugs abuse, kidnapping and ensures equitable income distribution in a the society. It is also a self-help measure adopted with full religious backing to support those poor and destitute who are unable to help themselves so as to alleviate misery and poverty from Muslim society.

Unfortunately, the neglect on this vital institution by the government, and the Muslims rich has devastating effect in the society as we are witnessing today. Youth unemployment, drug abuse, kidnapping, street begging, depression, indebtedness, domestic violence are more or less linked to social disconnect between haves and have not. Underneath is the issue of redistributive justice which zakat provides an effective mechanism to achieving that. Islam emphasises wealth circulation in the society. In fact, the parable of wealth and its circulation in a society is like the role of blood in a human body. If it circulates well, one is healthy, otherwise one could be dead or atleast being paralysed. Thus, zakat has great role to play in providing sustainable means of survival to many families in the rural and urban cities.

Ironically, the Zakat realised from some Nigerian states zakat agencies from 2009-2015 was N7 billion only. However, Islamic Social Finance Report (2015) of the Islamic Development Bank Jeddah, shows that zakat can easily

be used to fight poverty on USD1.25 per dollar. The data shows that zakat potential in Nigeria reaches up to 2.08 percent of GDP while resource short fall stands at 1.47 percent of GDP. This calls for policy makers and other rich Muslims to consider in earnest this Islamic social finance instrument to provide social stability and crowd out social evils in the society.

### **Nisab (Minimum Threshold)**

Nisab is a minimum amount of wealth that a Muslim must possess before giving out zakat. There are different form of nisab such as cash, agricultural produce, gold and silver, landed property and animals among others. While there is little or no difference on zakat on non-cash, scholars differ on the amount of money before once gives out his zakat. Some argue that gold should be the measure of nisab while others prefer silver. Originally it is payable on 200 Dirhams or 521 *tolas* (nearly 21 oz) in case of silver and 20 mithqal or 71 *tolas* in case of gold (nealy 3 oz). However, majority of scholars uses gold as a measure of cash to compute nisab. Generally, zakat on gold and silver (money) is 2.5 percent.

**Table 1. Types of Zakat, Haul, Nisab and the Quantity**

Types of Zakat	Haul	Nisab	Quantity
Zakat of Livestocks	Annually	40 Goats/30 cows	1
Zakat of farming Goods	Every farming season	520 grams of rice	5-10%
Zakat of Gold	Annually	85 grams of gold	2.5%
Zakat of Traded Goods	Annually	equivalent to 85 grams of gold	2.5%
Zakat of founded Treasure	As its found	equivalent to 85 grams of gold	10%
Zakat of Profession	As he/she receives	equivalent to 85 grams of gold	2.5%

Source: Haque et al. (2016)

Payment of Zakat certainly has social and economic significance in the society especially in developing countries like Nigeria.

### **Zakat Potential in Some Selected Countries**

Since inaugural work of Monzer Kahf on the 3 views on zakat collection from liberal to conservative views, there have been empirical researches that estimated the zakat potential in some countries such as Saudi Arabia, Syria, Sudan and Pakistan among others. However, in those studies the potential of zakat in terms of percentages to Gross Domestic Product were small. There are recent studies which are more systematic which show additional countries.

**Table 2. GDP Resource Gap and Zakat Estimates in Asia, Africa and Europe**

Country	Resource Gap as % of GDP at \$ 1.25 per day	Resource Gap as % of GDP at \$ 2.0 per day	Highest Zakat Potential
Bangladesh (2009)	7.57	33.36	3.93
Malaysia (2009)	0.00	0.02	2.26
Indonesia (2011)	0.35	2.74	3.82
Nigeria (2013)	1.47	3.50	2.08
South Africa (2010)	0.001	0.01	0.07
Sudan (2010)	0.49	2.20	3.47
Bosnia and Herzegovina (2014)	0.00 (\$1.9)	0.01 (\$3.10)	2.20
Tajikistan (2014)	1.04 (\$1.9)	7.30 (\$3.10)	4.30
Russian Federation (2012)	0.00 (\$1.9)	0.00 (\$3.10)	0.51

Source: Islamic Social Finance Report (2014, 2015, 2017), adopted from Muhammad (2019).

Recent findings show the potentials of *zakat* in overcoming the poverty challenges in Asia, Africa and Russian Federation. For instance, in Bangladesh, the resource gap needed to alleviate poverty of USD1.25 per day is 7.57 percent of GDP. However, the highest zakat potential in the country is 3.93 percent of GDP which implies that, at the moment, zakat alone may not be able to end poverty of 1.25 per day in the country. The corresponding figures in Malaysia show that resource gap is not an issue anymore. Yet, the potential of zakat in the country reaches 2.26 percent of GDP during the study period. The resource gap in Nigeria based on USD1.25 per day is 1.47 percent while the highest zakat potential is 2.08 percent of GDP. This shows that Nigeria could

alleviate the poverty level of 1.25 per day (2.08 is greater than 1.47). In South Africa, Sudan, Bosnia and Herzegovina, Tajikistan and the Russian Federation zakat has the potential to alleviate poverty as shown table 2 above.

**Table 3: Zakat Potentials in some selected African Countries**

<b>Country Name</b>	<b>Z1 (Million US\$, PPP)</b>	<b>Z2 (Million US\$, PPP)</b>	<b>Z3 (Million US\$, PPP)</b>	<b>Z1% Of GDP</b>	<b>Z2% Of GDP</b>	<b>Z3% Of GDP</b>
Kenya	126.56	270.71	305.16	0.13	0.27	0.30
Mauritius	66.62	142.50	160.63	0.30	0.64	0.72
Nigeria	8776.45	18771.85	21160.99	0.86	1.84	2.08
South Africa	178.87	382.58	431.27	0.03	0.06	0.07
Sudan	1843.51	3943.06	4444.90	1.44	3.08	3.47
Tanzania	456.75	976.93	1101.26	0.54	1.15	1.30

Islamic Social Finance Report (2015) IRTI, IDB.

Table 2 shows the zakāh potential in some selected Sub-Saharan African Countries. Except for Sudan and Nigeria, the countries are Muslim minorities. The zakāh potential in Sudan and Nigeria are the highest. In Sudan, the potential is USD 1843.51 million, USD 3943.06 million, USD 4444.90 million or 1.44, 3.08 and 3.47 percent based on Z1, Z2 and Z3 respectively. In Nigeria, the amount is USD 8776.45, USD 18,771.85, USD 21,160.99 million or 0.86, 1.84 and 2.08 percent respectively. The resource gaps in Sudan are 0.49 and 2.20 for Nigeria is 1.47 and 3.50 percent respectively. In Kenya, Mauritius and Tanzania, zakāh potentials are insignificant. For instance, Tanzania with 3.02 and 8.17 percent of GDP resource gaps has the potential of

realizing only between 0.54 to 1.30 percent of GDP of zakāh. This finding is revealing as the majority countries generate sufficient zakāh capable of alleviating poverty except in South Africa, which has the resource gap of 0.001 and 0.01 percent of GDP as compared to between 0.03 and 0.07. This means for these three countries they can easily get rid of poverty of 1.25 per day and USD 2 per day respectively. This also calls for more organized and institutionalised management of zakāh in those countries.

### **3.2 The concept of Waqf**

Waqf is a form of ongoing charity (sadaqah jariya) in which a gift is donated to bring a charitable return. Waqf is an irrevocable and perpetual charity which is meant to provide permanent and sustainable rewards to the donors while improving the socio-economic welfare of the society. It is a unique institution that has played historic role in the past and served as the mainstay of the economy of some Muslim empires and jurisdictions (Muhammad, Maidoki and Sani 2017).

Originally, the first waqf was that of Umar r.a when he asked the Prophet s.a.w “O Prophet of Allah, I have gained a valuable piece of land in Khaibar and I do not have any other thing more valuable than it. What do you command me to do with it?The Prophet s.a.w replied “If you wish, you can give its benefits to charity whilst preserving it- so that it can no longer be sold, nor may it be possible to give it away or bequeath it.” Cited in Muhammad, Maidoki and Sani (2017)

During Ottoman Empire, waqf reached its zenith to the extent that the government expenditure were largely sourced from waqf funds. The waqf land exceeded atleast one of third of total land in Egypt, Syria and Turkey.

In Nigeria, waqf was entrenched in the history of Sokoto Caliphate whereby there is specific person assigned officially to administer waqf properties i.e Mutawalle. Muslims also historically endows waqf largely for mosques purposes and others for Quranic schools, graveyards and construction of wells



among others. When colonial masters came the role of the institution was reduced. Yet, the presence of waqf is throughout the history of Sokoto caliphate that stretched from Nigeria to part of Cameroon, Niger and Benin Republics.

The constitution of Nigeria recognises waqf as a personal matter. So no much regulation was made. In Early, 2000s with the revival of Islamic law in Northern Nigerian states, enactments on zakat and waqf laws were made and the revival effort continues in States like Zamfara, Sokoto, Kano and Jigawa among others. In the South, NGOs established Zakat and Waqf Institutions such as Zakat and Sadaqh Foundation in Lagos is comparatively doing well in both collections and distributions.

### **3.3 Inheritance**

Inheritance system leads to redistribution of the total wealth of the deceased. The impact it creates differs depending on the system on inheritance itself. Under the system of primogeniture, the eldest son inherits almost everything. This leads to wealth concentration of the wealth among few hands. Under Islamic system of inheritance, a number of heirs are required. If there is a bequest it will not exceed one third for any of their heirs.

Timur Kuran, claims that inheritance inhibits growth by splitting lands and estate into small holdings. This claim may not be correct and obviously represents a static view of existence and the globe. The population growth makes people to permanently expand their living environment develop new areas of land and cultivate, build new houses etc. More so, it assumes that there is no possibility of trade and exchange among the heirs and even outside them. It also assumes there is no possibility of management of farm with joint ownerships.

### **3.4 Sadaqah and Gift**

Allah encourages spending in his course in form of voluntary charities. He says *“O you who believe! Give of the good things which you have (honourably)*

*earned, and of the fruits of the earth which We have produced for you, and do not even aim at getting anything which is bad, in order that out of it you may give away something, when you yourselves would not receive it except with closed eyes with disgust (Q:2:267).*

The holy Prophet encourages private expenditure on others and condemned those who shun from it. To show that there is sadaqat other than zakat a hadith of the prophet states that “There are rights (of God and the poor) in the wealth besides zakat” A verse added that “And in their wealth there is a known share for the beggar and the destitute” (Q: 70:2-25).

In another verse Allah says “And those who hoard up gold and silver and spend it not in God`s way...announce them a painful chastisement.”(Q: 9:3).

These and many other teachings on sadaqat indicate how important the act is in Islam. It is a flexible and a clear means of gaining closer to Allah and alleviating sufferings of the needy. Its socio-economic benefit cannot be over emphasized. It provides prompt and direct intervention to the beneficiary in form of food, water, clothes, medicine, transportation etc. It also saves life in period of famine. In addition, maintenance of the holiest sites is done with sadaqah fund while in some cases with awqaf fund.

#### **4.0 Conclusion**

Islamic welfare system pays more attention to the fulfillment of basic needs of especially the poor and the needy where it specifically mentioned poor and needy persons as the first categories of Zakah beneficiaries. Therefore it is more comprehensive and more efficient and the Pareto optimality. The contentment of the heart and pleasure derived from helping the needy persons in Islam is more than the satisfactions derived from utility or profit maximizations in conventional economics.

## 5.0 Summary

This unit discussed the concept of Islamic welfare system where it emphasized on the benefits peculiarities of Zakah, Waqf, Sadaqah and benevolent spending in Islam. Zakah is a compulsory payment of specified amount on wealth reached specified amount during a specific period of time. Waqf is a voluntary and philanthropic spending for catering the necessities and basic needs of the society by allocating and dedicating wealth for the specific use of specified categories of people. The unit also shed lights from Qur'anic verses on the benefits of giving sadaqah and gift for the sake of Allah.

## 6.0 Tutor marked-assignment

- (1) Discuss the economic implications of Zakah
- (2) What do you understand by Islamic welfare system?
- (3) Explain the economic implications of Waqf endowment.

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