1. Islam, the economy and economic life

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BACKGROUND

There are a large number of articles and books on the topic of Islamic finance. A smaller number of studies, particularly in recent years, have been devoted to the study of Islamic economics. To our knowledge, however, there is no volume that considers Islam and the broader economic sphere, that is, how Islam shapes, and interacts with, the economy and economic life.

Why is there a need for such a volume? An obvious starting point is that, according to the 2009 Pew Forum on Religion and Public Life report, 1.6 billion, or nearly one in four people in the world, are Muslims (60 per cent in Asia, 20 per cent in the Middle East and North Africa, 15 per cent in sub-Saharan Africa, 2.4 per cent in Europe and 0.3 per cent in the Americas). There are 57 Muslim majority (Organisation of Islamic Cooperation, OIC) countries. In addition, one in five Muslims live in a country where Islam is a minority (160 million in India, 38 million in Europe and 5 million in the Americas). Clearly Muslims are an important part of the world economy.

But why *Handbook on Islam and Economic Life* and not, say, a study of the economies of the various Islamic countries, such as the contribution of the OIC countries to the world system? An overriding reason is that Muslims everywhere ought not to separate economic activities from the religion – the pursuit of economic activities needs to be based on moral and legitimate foundations. Islam commands authority over the totality of a Muslim's being, and does not accept any distinction between the sacred and the secular. Economics, politics, and religious and social affairs fall under the jurisdiction of the divine law of Islam – the *Shariah*. Based on *Shariah*, Islam has formulated a comprehensive ethic governing how business and commerce should be run, how accountability to God and the community is to be achieved, and how banking and finance are to be arranged. All of these components pose unique challenges in a global business environment largely unsympathetic to these religious-based values. Some of the chapters in the book deal with many of the controversies which arise from the clash between tradition and modernity, and issues of whether and to what extent present-day practices hold true to the spirit of the divine rulings and exhortations.

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Many of the chapters draw, albeit to varying degrees, upon the discipline of Islamic economics. This subject is very different from – indeed the opposite of – the economics of religion. The economics of religion applies the concepts and models of standard economic analysis to study the marketplace for religion (Ekelund et al., 2006; McCleary, 2011). Islamic economics, by contrast, seeks to apply and integrate the religious principles of Islam with economics with the aim of moulding economic analysis in a way appropriate for a Muslim's economic behaviour.

Islamic economics remained primarily an integral part of the unified social and moral philosophy of Islam until after the Second World War. It only assumed the shape of an independent discipline in the second half of the twentieth century as intellectuals in many lands with majority Muslim populations began to reflect on alternative modes of post-colonial social organization. Neither of the then prevailing secular models of economic organization, namely, communism and capitalism, fitted well with the Islamic ethos. The new research programme that developed distinguished itself from the conventional paradigm in many ways. Citing M. Umer Chapra (2000):

The Islamic paradigm . . . gives primary importance to moral values, human brotherhood, and socio-economic justice and, unlike its Marxist or capitalist counterparts, does not primarily rely on either the state or the market for realizing its vision. It rather relies on the integrated role of values and institutions, market, families, society, and the state to ensure *falah* or the well-being of all. It places great emphasis on social change through a reform of the individual and his society, without which the market and the state could both perpetuate inequities. (p.57)

Despite this broad conception, the field soon became narrowed considerably as the commercial interests of the bankers and practitioners combined with the publishing ambitions of academics to elevate banking and financial issues above all others. Islamic economics became virtually synonymous with Islamic finance. One of the aims of this collection is to encourage scholars to move away from some of the often overworked issues in finance and hopefully revive interest in some other aspects of Islamic economics. To this end, only two of the eight parts deal directly with issues of Islamic finance. Accordingly, the volume is structured around how Islam impinges upon, and seeks to shape, the major aspects of economic life generally – hence the title *Handbook on Islam and Economic Life*.

DEVELOPMENTS IN ISLAMIC ECONOMICS

In deference to the heritage of Islamic economics, it is appropriate that the first part of the volume considers the development of Islamic economics, and the four chapters in their different ways explore the interrelationships between Islamic and conventional economic analysis.

Conventional economic analysis is normally dated, at least in the English-language studies, from Adam Smith and *The Wealth of Nations* (1776), although Mark Blaug in his *Economic Theory in Retrospect* (1968) devotes one chapter to 'Pre-Adamite Economics' (bullionists, mercantilists and physiocrats). Sir Eric Roll in *A History of Economic Thought* (1956) wrote that, 'in the three centuries that elapsed between the end of the Middle Ages and the appearance of *The Wealth of Nations*, the classical system of political economy was being prepared' (p. 54), citing in particular Sir William Petty, David Hume and Richard Cantillon. However, few date back to the seventh century, when Islam was born and Islamic economics took root.

Unlike Christianity, which evolved within a feudal structure in which many (if not most) transactions were in kind, Islam was at its inception confronted by the reality of the market economies of Mecca and other Arabian trading towns and with the need to appreciate the workings of the market. The Holy Qur'an (as opposed to Christianity) laid down principles that needed to be followed (e.g. absence of *riba*, elimination of uncertainty (*gharar*) in contracting, and prohibition of gambling (*maysir*), exploitation and speculation) to put lawful economic activity on a firm ethical and moral foundation – 'justice in exchange' (Iqbal and Lewis, 2009). While the Qur'anic principles were clear and forthright, their elaboration and implementation relied not only upon the sayings and doings of the Prophet Muhammad (the collection of *hadith* that form the *sunnah*, or traditions) but on the use of mind (*ijtihad*) and the application of analogical reasoning (*qiyas*) by Islamic scholars to build a body of law (*Shariah*) to guide economic life.¹

Against this background, Islahi in Chapter 2 examines the contribution of Muslim writers to economic thought, over three distinct periods in Islamic history starting with the flourishing centuries of Islamic culture and scientific thought from the advent of Islam in 622 CE that continued up to the fifteenth century. Names such as Abu Yusuf (731–98), al-Qurashi (752–818), al-Dawudi (d. 1012), al-Mawardi (974–1058), al-Ghazali (1058–1111), Ibn-Taymiyyah (1263–1328), al-Shatabi (d. 1388) and Ibn Khaldun (1332–1406) mark a significant analysis made of economic issues in this era, a tradition unfortunately not carried over to the second period – described by Islahi as the decaying phase – between the

sixteenth and nineteenth centuries when economic analysis by Muslim writers stultified and little new of note emerged. In the third period beginning in the nineteenth century, there was a reawakening of interest, leading eventually to the development of the main planks of the discipline of Islamic economics, maintaining a tradition which combines revealed knowledge and creative thinking about economic matters. Islahi concludes by outlining key features of Islamic economics.

The other chapters in Part I continue the exploration of how the discipline of Islamic economics differs from conventional economic analysis. Utility maximization features in both, but in very different ways. A Muslim accepts revelation as a source of knowledge on metaphysical issues as well as on ethics and justice. By contrast, the whole evolution of standard economic methodology has been in the direction of getting rid of values and ethical theory. In particular, economic theory construes a person as a collection of preferences (attitudes, tastes, actions and laws) that adjust to the changes in the costs and benefits of resources to maximize present utility. By comparison, Islam considers a human being as a servant and vice-regent of God on earth. It is from this perspective that Islam lays great stress on keeping one eye on the material and another on the spiritual.

In Islamic economics the concept of utility is widened in three ways. First, utility or satisfaction is broadened to encompass the spiritual as well as the material. Second, utility is extended temporally from this life to the hereafter. Third, there is explicit recognition of communal obligations and that well-being cannot be acquired in any true sense without a concern for the welfare of others. The corollary is that the rational being is replaced by the 'faithful' being, who pursues personal interests within social bounds and communal interest. The faithful person relies on moral forces such as altruism, cooperation, brotherhood, fraternity, affection and mutual respect to rein in his selfish nature and lust for riches (Ahmad, 1991).

Participation in economic activity in Islamic economics becomes a religious responsibility in which the individual is allowed to pursue his or her own personal goals while complying fully with the community's norms, values and expectations. In this respect, individual freedom of decision making is not absolute and has to be moderated and constrained by rules which are designed to ensure that others enjoy similar freedoms. That, in essence, is what *Shariah* seeks to achieve. Economic resources and human endeavours are to be employed to seek utility or satisfaction at two levels, the material and the spiritual, so that economic activity is both financially and socially beneficial. This requirement is in recognition of the belief that without spiritual enrichment achievement of material fulfilment is ephemeral and ultimately untenable, since a balance of the two is needed for the full development of the individual and society.

In effect, as Asad Zaman argues in Chapter 3, from the Islamic perspective even the most basic decisions about how to organize economic affairs – what commodities to produce, how they will be produced, that is, by whom and with what resources, and for whom the goods are produced – cannot be made without first specifying the purpose of economic life. Put simply, the answer is that the purpose of economic activity is to earn the pleasure of God (Allah). All meaningful human activity, economic or otherwise, is directed towards the Day of Judgement. Any other kind of activity is either meaningless or harmful in distracting people from this purpose. Critics may argue that it may be possible, at least in theory, to reach much the same result by the device of assuming infinitely lived economic agents, but Islam offers a more dynamic and complex view in terms of a battle between conflicting tendencies within the hearts of man. Instead of evaluating people and societies in terms of their ability to produce wealth, wealth is seen as a means of purifying the heart. As a result, Islam seeks to transform society in directions not envisioned in contemporary economic theory, which as Zaman points out requires a radically different approach, which the Islamic paradigm offers.

Nevertheless, the differences between Islamic and conventional analysis can be overstated. In a world of abundant economic resources, relative to demand, there would be no economic problem. Accordingly, mainstream economics² has its foundations in three building blocks: grappling with the scarcity of resources, pursuit of self-interest in economic activities, and maximization of productive gains from involvement in economic life. These propositions ought not to be ignored, but rather should be viewed from an Islamic perspective. Consider again the three foundations of mainstream economics, namely, scarcity of resources, pursuit of self-interest and maximization of gains. In terms of scarcity, it is recognized that the provision of resources and their availability to mankind are separate matters. Islamic economics emphasizes that resources are God given and thus inexhaustible. Yet their provision to mankind is a function of the application of human knowledge and effort. Second, Islam does not deny self-interest, but requires it to be pursued within the moral and social boundaries of Islam. Acts of selfishness cross those boundaries. Third, and again within the boundaries, there is little quarrel with maximization per se. Maximization is needed for efficiency of resource use in the face of scarcity, and remains a valid method of analysis in Islamic economics (Hasan, 2002).

Following in this vein, Muhammad Nejatullah Siddiqi in Chapter 4 questions the hostile nature of many of the modern contributions to Islamic economics in its post-colonial formative years and recommends that the earlier confrontational stance be replaced by a cooperative,

collaborative effort with the rest of humanity in order to solve the problems of poverty, inequality and ecological imbalances. At an analytical level, Siddiqi puts the case for changing the conventional market-focused view of the economy with one starting from the family and recognizing the role of community-based initiatives in the economy, especially in promoting philanthropy. This theme is taken up in later chapters, as are his views on minimizing the role of debt in finance and monetary management and expanding risk-sharing approaches.

Finally, in Chapter 5, Habib Ahmed begins by briefly presenting and reviewing the debate on the approaches taken by Islamic economists to develop the discipline vis-à-vis conventional economics and argues that the principle of permissibility should be used in Islamic economics when considering the usefulness of conventional theoretical tools. Based on this position, the chapter then presents the elements of the equi-marginal principle analytical framework that is used in conventional economics to explain how choices are made by economic agents. Each element of the equi-marginal principle is assessed to ascertain if it is in contradiction with *Shariah* principles. Examples are provided to demonstrate how an appropriately modified equi-marginal principle framework can be used to examine choices made by 'Islamic man' based on ethical considerations.

THE PROBLEM OF INTEREST

The abolition of interest is one of the core principles of Islamic economics, yet it remains as controversial today as it did when Caliph Umar (ibn Al Khattab) expressed his regret that the Prophet did not live long enough to explain fully the meaning of *riba*.

Shamim A. Siddiqi in Chapter 6 revisits matters first raised by Fazler Rahman (1964) and debated in later studies. The issue has come to prominence in Islamic economics because jurists have ruled the payment or receipt of interest in banking and other loan transactions is not permissible while at the same time ruling it allowable for a rate of profit, even if indexed to a market interest rate such as LIBOR used as a benchmark or indicative rate, to be levied on certain asset-based or related transactions. Siddiqi argues that it is untenable to accept a positive time value of money in deferred payment sale and disallow the same in interest-based transactions, and then goes on to evaluate the arguments for and against the permissibility of charging a higher price in a deferred payment sale. Controversially, he makes the 'man from Mars' (in this case students in his class) observation:

From this author's experience of teaching Islamic economics for 20 years, students in almost every class commented that they do not see any difference between buying a car through an Islamic bank on deferred sale with higher than cash price and buying a car after borrowing money on interest from a bank.

... One can make money through this trade (*bai*) or lending money on interest. The former is permitted in Islam and every other religion while the latter was once prohibited by all monotheistic religions and even in Hinduism. Does it make sense that on one hand Islam requires 0 per cent interest on cash loans but allows any rate of (effective) interest rate through deferred payment sale?

This observation is a valuable counterpoint to the following chapters by Kahf and Subhani, which delve into the reasons why such a distinction may be justified.

Monzer Kahf in Chapter 7 examines the widespread perception that Islamic finance is distinguished from conventional finance by virtue of its being asset based, while conventional banking is not necessarily so. Instead, it is argued that asset-based financing is a necessary, but in itself not sufficient, condition. Rather, the assets involved must be growing and generating return, and the underlying transaction has to be for this intended purpose. The upshot is that Islamic finance should not be defined by its prohibition of interest. Instead it should be seen, in Kahf's words, 'as the provision of goods, services and means of payment with the counterpart being delayed for a future date. In other words, Islamic finance tools, instruments or contracts are only sale, lease and sharing.'

In Chapter 8, the final chapter in Part II, Azeemuddin Subhani also focuses on sales-based financing. In particular, he analyses the key verse in the Holy Qur'an 'God hath permitted trade and forbidden usury' (2:275) in the light of other pertinent verses and supporting Prophetic sayings (*ahadith*), the difficulty arising from the complexity of the concepts of *riba* and *bay*. He also questions, and takes to task, the common perception that Islamic finance must necessarily be risk based as summarized by the adage 'No risk, no reward.' Subhani contends that scholarly linguistic liberties and miscomprehension of some fundamentals of finance have led to fatal flaws in reasoning and practical misdirection of the Islamic finance paradigm and its compliance mechanism. As well as challenging existing interpretations, the chapter offers a 'seminal' theory of Islamic financial law based on new exegetically developed, judicially tested, generally applicable operative principles to steer the Islamic financial structure.

ECONOMIC ORGANIZATION

In broad terms, much of the economic organization of a Muslim country, or of countries with large Muslim populations, is little different from that of other countries. Goods are produced, bought and sold; people are housed and schooled, travel to work, and make use of the leisure and entertainment industry. Yet one important difference is the nature of the food industry due to *halal* dietary laws that determine what foods it is lawful or allowable for Muslims to consume.³ Chapter 9 by Joe M. Regenstein, Mian Nadeem Riaz, Muhammad Chaudry and Carrie E. Regenstein reviews the major rules of *halal* food to provide guidance in determining whether a product can be certified as *halal* and examines the size and scope of the *halal* market globally. It looks at some of the more controversial issues with respect to *halal* foods and the role of certification by both government and non-government bodies along with proposals for the future. An interesting development of relevance to Muslims living in Muslim minority countries such as the United States, the UK and Australia is the potential for small changes in the production process to serve both the *halal* and the kosher food markets.

Mohamed Ariff and Meysam Safari in Chapter 10 undertake a socio-economic snapshot of Muslim majority countries over a six-year period ending in 2010. The authors discover that the 57 Muslim countries made significant progress over the last 60 years since becoming independent from their colonial masters and, perhaps surprisingly to some, find that the progress of these Muslim countries is comparable with that of the rest of the world, especially the developing countries. However, there can be no guarantee that this performance can be sustained. The instability of some Middle East and North African (MENA) countries recently indicates that the future of Muslim majority countries will be conditioned as much, if not more, by choices made in the political arena as well as in the economic area.

It is often said of many developing countries that the most underutilized asset (at least in terms of work effort) is the male population. An oft-repeated criticism of Muslim countries – particularly by Western observers – is that underutilization is a feature of the female labour force. Chapter 11 by Ismail H. Genc, George Naufal and Bassam Abu Al-Foul researches the situation. It examines the current and historical record of woman's participation in the labour force in Muslim countries and finds that women in Muslim countries indeed lag behind their counterparts in non-Muslim countries in terms of participation in the labour force. In particular, the MENA region has one of the lowest female labour participation rates in the world. Although this statistic masks a considerable

disparity, there is the question of why. Is it due to religion or other influences? The authors' empirical study suggests that cultural factors seem to play the larger role, and may even distort the data. Genc, Naufal and Abu Al-Foul call for more culturally sensitive data collection on the issue, and therefore evidence-based research.

BUSINESS AND MANAGEMENT

Accountability to God and the community (*umma*) is central to a Muslim's faith, and this responsibility is reflected in accounting principles, corporate governance, business ethics and attitudes to corruption.

Accounting is the topic of Chapter 12. Roszaini Haniffa and Mohammad Hudaib consider some of the underlying problems in conventional accounting that are deemed inappropriate for Islamic business organizations in fulfilling the objectives of Islamic teachings. In particular, the chapter provides a critical analysis of three interrelated issues in accounting, namely, recognition and measurement, disclosure, and enforcement, to which Islamic business organizations need to pay attention in order to meet their accountability to stakeholders. More importantly, their analysis highlights the implications of the Islamic worldview on accounting policies and practices.

Corporate governance principles are outlined in Chapter 13. This chapter examines corporate governance in general and Islamic corporate governance in particular. It also analyses the gap between reality and practice in Islamic corporate governance. While in Western corporate governance systems the model that rules is a stockholder-based one, in the Islamic corporate governance framework the underlying principles point to a stakeholder-based model, which takes into consideration the views of all stakeholders in the corporation. A consultative process involving all stakeholders is the key to Islamic corporate governance principles, with *Shariah* governance assuming the primary role in corporations and the ombudsman playing a key role in public institutions. While there are general corporate governance principles outlined in Islamic public policy, there are no codified laws or articles enacted yet in the Islamic polity, the need of which is paramount and should be based on the general *Shariah* principles.

Rodney Wilson in Chapter 14 analyses economics and morality from an Islamic perspective. He starts from the premise that economic policy making has moral implications and cannot be considered value free. From this basis, he considers how religious belief, and in particular Islam, provides a moral framework for economic decisions. For this purpose,

he provides a review of the literature on the economics of religion, which has largely been neglected by Islamic economists, analyses *zakat* collection and disbursement from an economic perspective, and finally explores how Muslim faith provides a spiritual prism to evaluate the morality of economic development and material advance.

A natural extension of Wilson's line of argument concerns the Islamic position on corruption, and in Chapter 15 Iqbal and Lewis focus on this topic. Corruption is a topic not extensively examined from an Islamic perspective, and the authors elucidate both the Islamic and Western views of corruption, and how each polity tackles the problem of corruption. Western systems have various measures – both political and administrative – to reduce the economic and social costs of corruption. Islam places more emphasis on internal purification to reduce corruption, while the Western world gives priority to civil and administrative measures to curb corruption. The chapter concludes that neither approach is adequate: internal restraint (Islam) and external constraint (the Western solution) in isolation are insufficient. The corollary is that Islam and the West both can learn from each other by using a combination of ethical and practical measures to contain corruption.

FINANCE AND INVESTMENT

Clear legal principles govern finance and investment in Islamic capital markets. Islamic law bans interest, short selling and speculation, and stipulates that income must be derived as profits from shared business activities and trading (sales) operations rather than as a guaranteed return. This is seemingly an unwelcoming environment in which to flourish for many modern financial instruments, such as financial derivatives, which feature so prominently in Western finance. Indeed, Islamic jurists contend that derivatives contain excessive uncertainty (*gharar*), encourage speculative behaviour akin to gambling (*maysir*) and/or enrich claimants unjustly.

This situation sets the stage for Chapter 16 by Andreas A. Jobst, which brings fresh insights to the state of the Islamic debate on derivatives. In particular, Jobst examines whether the fundamental legal principles of the *Shariah* can be reconciled with the risk-shifting proposition of derivatives contracts in spite of explicit religious prohibition of *gharar*, *maysir* and unilateral enrichment from monetary exchanges without the creation of real value under Islamic jurisprudence (*fiqh al-muamalat*). Jobst presents a classification scheme of existing derivatives in Islamic finance and applies a novel valuation approach to illustrate the existence of implicit derivatives in traditional financial contracts. The chapter derives axioms for the

permissibility of certain types of derivatives in Islamic finance based on the arguments raised in the current scholastic debate in this area and the characteristics of existing *Shariah*-compliant contracts with derivative-like features. Finally, the chapter also discusses the current development of *Shariah*-compliant derivatives as genuine hedging instruments and their prospects in the context of financial innovation in Islamic finance.

Jobst's chapter draws attention to the central role that rulings by the *Shariah* scholars play in the development of Islamic finance markets. In Chapter 17, Mohamad Akram Laldin and Hafas Furqani elaborate that role, arguing that it is effectively the *Shariah* scholars, in their function as interpreters of the *Shariah*, who are charged with guiding the industry. In the chapter, Laldin and Furqani evaluate the expected qualities of *Shariah* scholars in supervising and guiding Islamic financial institutions, compare the different practices of Islamic finance *Shariah* supervision and *Shariah* governance across jurisdictions, and consider the challenges in developing the best practices of *Shariah* supervision and *Shariah* governance in Islamic financial institutions.

Chapter 18 by M. Kabir Hassan and Ouidad Yousfi achieves two purposes. First, it brings out that private equity is a well-developed asset class in Islamic finance, running parallel to the open-ended mutual fund or unit trust-type investment vehicles which feature in Chapter 19. Islamic private equity is prominent in the Middle East, where Islamic banks establish investment funds to invest directly in unlisted companies engaged in project developments. There is a literature based around corporate governance which sees the growth of private equity generally as overcoming some of the agency problems inherent in finance when the private equity firms take over the management functions or bring new management skills to bear on the operation.

However, in terms of Islamic private equity there is another advantage. The authors show how the introduction of profit-loss sharing (PLS) financing methods can solve asymmetric information under moral hazard. *Mudaraba* financing contracts are incentive compatible, as Islamic private equity is a passive investor and the project success depends on entrepreneurial efforts that can lead to a first-best solution. *Musharaka* financing solves the moral hazard problem, as both parties exert capital and labour in the project and, if one shirks his responsibility, he will share the consequences as a result.

Earlier, in Chapter 7, Monzer Kahf argued that Islamic finance cannot be defined by what it is not. Rather, it must be defined by what it is. In Chapter 19, Nurul Aini Muhamed and Mervyn K. Lewis make a not dissimilar point. Ask 'the man in the street' what Islamic banking and finance are about and he or she is likely to respond (if at all) by talking about the

‘negatives’ – Islam bans interest, prohibits gambling and speculative activities, and does not allow involvement in, or the financing of, alcohol and the production of pork. That is, the answer received is more likely to revolve around what Islam is against, rather than what it is for. Muhamed and Lewis argue that, if Islamic investment funds are to reach their full potential as an avenue for investment in a globalized setting, there needs to be a greater emphasis on investment strategies on the ‘positives’, what Islam stands for in terms of the promotion of justice, trust, brotherhood, almsgiving and so on, rather than fund managers taking the easy way out and implementing the negative screens and cleansing filters. The authors also consider potential growth factors and maintain that Islamic funds can benefit considerably by following conventional ‘ethical’ funds down the ESG (environmental, social, governance) investing route, and having the fund managers become more active in monitoring investee firm governance arrangements.

The first *sukuk* was issued in 1990. Since then the market has grown rapidly to be a major component of the Islamic global financial services industry. However, some well-publicized defaults and near-defaults in the wake of the global financial crisis have raised some question marks as to whether the growth momentum can be sustained. In Chapter 20, Umar A. Oseni and M. Kabir Hassan review the situation, and argue that future growth depends on both proper regulation and appropriate supervision, which they are careful to point out are not the same thing and need distinguishing. *Shariah* scholars’ rulings are often seen as setting the pace of industry expansion. But in the case of *sukuk*, where complex legal issues surfaced in the default events, lawyers may play the role of chief pacemakers (Radzi and Lewis, forthcoming).

In Chapter 21, the final chapter in Part V, Adewale Abideen Adeyemi and M. Kabir Hassan explore Islamic microfinancing. Microfinance has expanded rapidly since the Grameen Bank experiment in Bangladesh drew attention to this unique financing approach. The chapter accentuates the fact that Islamic microfinance gives due cognizance to both the mechanics and the spirit of providing requisite financial services to the poor in a manner that promotes socio-economic and spiritual inclusiveness as underlying philosophies of true microfinancing. It argues the imperative and implication of having such a *Maqasid-Shariah*-based microfinancing. *Maqasid ash-Shariah* aims essentially at protecting the faith (*deen*), life (*nafs*), intellect (*‘aql*), posterity (*nasl*) and wealth (*mal*) of mankind, which are referred to as *al-Daruriyyat al-khamsah* (the five fundamentals or necessities). Finally, relevant data from institutional sources are used to trace the rationale for the evolution as well as to give insights into the current outreach and sustainability of Islamic microfinance around the Muslim world. The chapter also serves as a lead into the next part.

CHARITY, MUTUALITY AND SELF-HELP

It is almost facile to describe poverty as a deep-rooted, age-old problem, but that regrettably is a fact of life. The relevant questions are how serious it is and what to do about it. In Chapter 22, Abdul Ghafar Ismail and Bayu Taufiq Possumah provide a very different slant on the first question by emphasizing that, from the Islamic perspective, poverty exists in two dimensions, materially and spiritually, and that (perhaps not unsurprisingly) the latter has been neglected in the conventional literature. From this broader platform the authors explain poverty in an Islamic epistemological view, materially and spiritually, provide and describe the causes of poverty in a comprehensive perspective, outline Qur'anic guidance to alleviate poverty, and its framework for poverty alleviation, and introduce *zakat* as the basis of a social security agenda.

Zakat plays a major role in Islam. First, it is one of the five 'pillars' of Islamic faith designed to purify wealth. Second, it is directed to charities to alleviate poverty. Third, it is a core element of the Islamic system of taxation. This trio of functions is the topic of Chapter 23 by Zafar Iqbal and Mervyn K. Lewis. The chapter examines the historical and modern role of *zakat* and taxation in the Islamic polity and analyses how jurists over time have viewed principles of justice in taxation with special emphasis on *zakat* as a tool for redistributive justice in society. A feature of the analysis in the chapter is its explanation of how *zakat* can be integrated into the taxation system in a Muslim country in a way that will preserve the objective of *zakat*, its collection, and the impact on economic development and horizontal equity between Muslim and non-Muslim citizens. Finally, the authors offer pointers as to how modern *ijtihad* can be utilized to increase the range of income and wealth subject to *zakat*, along with how *zakat* receipts can be collected and distributed in society keeping in mind vertical and horizontal equity.

Waqf is a venerable institution of Islamic society used for the financing of charity work, the building of mosques and the provision of other social infrastructure. Tunku Alina Alias in Chapter 24 examines its historical and present-day role. In most Muslim countries, the early role of the *waqf* in providing public and municipal services has been taken over by the government. Consequently, today the *waqf* cannot exist in a vacuum, and must operate within an environment consisting of many non-profit and charitable organizations. Yet the institution of *waqf* is adaptable and flexible and is able to respond to local needs. Political will and scholarly work are needed to move this sector forward to attain its full potential. A recent controversy has emerged over Timur Kuran's (2011) contention that family *waqf* have been used for tax avoidance and to circumvent

Islamic inheritance laws. Tunku Alina Alias reviews Kuran's argument and strongly disputes his conclusions.

GOVERNMENT

Murat Çizakça in Chapter 25 considers the economic role of the state in Islam. Islamic economists have long envisaged what the role of the state ought to be in a modern Islamic economy. While not neglecting this normative viewpoint, Çizakça approaches the problem from a different point of view, and asks what the role of the state in Islamic economies has actually been. Such an approach allows him to investigate the degree to which actual historical practice has diverged from the theoretical ideal. This account is followed by two questions: 'With what consequences?' and 'How can we improve the economic role of the state in a contemporary Islamic country?' The latter question effectively catapults the reader from the past to the future.

Political authority in Islam is the topic of Chapter 26 by Muqtedar Khan. In the first Islamic state, the concept of political authority was straightforward, with the Prophet Muhammad as religious founder, political leader, head of state and spiritual guide, and he achieved unparalleled success in establishing the new religion as the foundation of the state and society in a little over a decade. The state was based on a treaty or social contract referred to as the *Dastur Al-Madinah* (Constitution of Medina), establishing the importance of consent and cooperation for governance and treating Muslims and non-Muslims as equal citizens of the Islamic state, with identical rights and duties. Thereafter, with the Caliphate, Umayyads, Abbasid and Buyid dynasties, Seljuks, Mongol domination, the Ottoman empire and later ruling families and military rule, matters were less harmonious and the concept of political authority unsettled. Conceptually speaking, Khan draws a distinction between 'Islamic theories of the state' and 'theories of the Islamic state', the former typifying theories of the nature of the state and political authority in the Classical and pre-colonial eras, and the latter the examination of these issues in post-colonial times. In his review and analysis of modern literature on the concept, Khan notes that a number of issues stand out, revolving around an ideology which is hostile to the West, rejection of secularism and the separation of religion and politics, sovereignty of God, application of *Shariah*, and the advocacy of democratic procedures for selecting rulers – matters which seemingly continue to resonate in the Muslim world today.

What used to be called public finance has been addressed by leading Muslim scholars of the past referred to earlier, without necessarily reaching

agreement on the question of whether Islamic economics should study and contemplate budget deficits. In Chapter 27, Monzer Kahf emphatically answers in the affirmative and provides an authoritative examination of budget deficits and public borrowing in an Islamic system. Starting from fundamental propositions, he concludes (along the lines of Buchanan, 1958) that the principles of financing that guide individual behaviour also guide public-sector financing. The chapter also analyses the causes and consequences of budget deficits and various ways of providing public goods from an Islamic viewpoint. Debt-based, equity-based and revenue-sharing modes of financing instruments can be used to finance budget deficits with specific *Shariah* restrictions of each of these instruments. However, Kahf argues that only equity-based financing creates a secondary market that allows an optimal asset allocation in the society.

RELIGION AND DEVELOPMENT

Volker Nienhaus in Chapter 28 points out that the relationship between religion and development is a complex one – development can impact on religion and religion can affect development. Nienhaus focuses on only the second of these, in particular on the content and teachings of religions and their possible links to development. He points to many commonalities between mainstream concepts of an Islamic economic system and models of a social market economy or welfare state in Christian countries and discusses the developmental relevance of a major difference, namely the prohibition of interest. As an example, the chapter shows with reference to Catholic social teaching and liberation theology how the context-sensitive interpretation of religious values depends on economic theories and how different theories can lead to radically different assessments of socio-economic realities and calls for political action.

Why did Islamic countries experience what Timur Kuran (2011) calls the ‘Long Decline’ and, from their position of superiority, fall behind the West economically, technologically and militarily? Given the role that Weber ([1904–05] 1930) and Tawney (1926) attribute to religion in the growth of Western capitalism, what importance, if any, should be attached to Islam in the juxtaposition of relative economic fortunes? Jared Rubin in Chapter 29 gives a valuable overview of four sets of recent institutional explanations of the long-run economic stagnation of Islamic economies, arguing that institutional explanations are less ad hoc than most other explanations, as they can explain both the early success of Islamic economies and their ultimate stagnation. The chapter shows how Greif’s ‘cultural institutions’ theory, Blaydes and Chaney’s ‘slave soldiers’

theory, Rubin's 'political legitimacy' theory and Kuran's 'Islamic law' theory each focus on institutional differences between medieval Europe and the Middle East. Moreover, these four hypotheses complement each other more often than not.

Chapter 30 by James E. Rauch and Scott Kostyshak examines the three Arab worlds on the eve of the 'Arab Spring'. In the chapter, Arab human development is examined over the period 1970–2010, and for this purpose the Arab world is disaggregated into three country groups: sub-Saharan, fuel-endowed, and a Mediterranean remainder. It is found that in most areas of human development each Arab country group is converging to its counterpart in the rest of the world. However, key exceptions are the gender gap in labour force participation and, before the 'Arab Spring', democracy, and the role of Islam in these exceptions is evaluated.

Economic development in the Muslim world over the remainder of this decade, however, seems destined to be shaped by the aftermath of the financial crisis and the long shadow that it is casting over the developed world, putting a brake on the world economy. Did the financial crisis need to happen? Might it have been avoided if Islamic financing principles had been followed? This is the question posed in Chapter 31. Although a definitive answer is not, of course, possible, there are ethical dimensions to the global crisis that cannot be overlooked. It is argued that the global financial crisis has its origins in lax risk management, poor regulation, speculation, excessive leverage and debt-based monetary policy, but more so in large part in the ethical and moral failure of the actors in this crisis. Moreover, the post-crisis responses cut against the grain of issues of balance and fairness that are the hallmark of Islam, in fact all three great monotheistic religions. Rather than endless revamping and introducing new sets of regulations, adherence to basic principles of ethics is not only desirable for itself, but needed to avert a future financial crisis.

NOTES

1. In some respects there are superficial similarities to the development of Jewish law in which the written (Mosaic) law (Pentateuch) has been supplemented by the oral law (Talmud).
2. As reflected, most especially, in Paul Samuelson's classic *Foundations* (1947).
3. Notably, however, *halal* food is not confined to Muslims, nor is the *halal* industry limited to food, and includes chemicals, healthcare, cosmetics, pharmaceuticals, and leather products marketed under a 'healthy' and 'sustainability' trademark. See Porter (2014).

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