Fundamentals of Islamic Economics and Finance

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Islamic Economics emerged as a distinct academic discipline during the last quarter of the 20th century. The First International Conference held in Makkah (1976) provided the necessary impetus when several independent institutions came into being thereafter, meant for carrying forward teaching and research in Islamic Economics and Finance. The role of the Islamic Research and Training Institute of the Islamic Development Bank is evident in this regard. To achieve this objective, the IRTI has been collaborating with other institutions worldwide since its establishment in 1981. Islamic Economics and Finance is now taught in many universities throughout the IDB/OIC member countries as well as in some European universities at the bachelor’s, master’s and doctorate levels. A number of conferences, seminars, workshops and symposia have been conducted so far and research material is now available as proceedings, books of reading, reports and research papers etc., with a significant part published by IRTI. However, sorting out the ‘needed matter’ out of this vast body of literature is really a difficult task for undergraduate students according to their syllabi and courses of studies. The students are often constrained by limited time frame of the semester and therefore have to concentrate only on selected themes.

The need for a standard textbook that should cover the necessary topics in simple, lucid but comprehensive manner has been felt for a long time. IRTI is privileged to present this book to fulfill this need. The authors have been practically involved in teaching of Islamic Economics and Finance at the university level for quite some time. Their hard work of completing the assigned task with professional rigor and within the scheduled time-frame is commendable. They adopted a systematic methodology of clarifying the basic concepts in the first part, followed by extensive elaboration on economic theory in the second and on the working of an Islamic system in the third part. The final part gives a brief account of the Islamic economic heritage and the performance of Muslim countries in the present scenario. The authors have followed a comparative approach in the text, explaining the concepts of Islamic Economics and Finance side by side with the conventional economic theory and policy. This approach seems to be appropriate for the primary audience, rather inevitable for a better understanding of Islamic Economics, although the experts in the field may find the description of conventional concepts cumbersome. The readers who are well versed in conventional economics may bypass such details and focus on the Islamic themes without loss of generality.

As stated above, composing a textbook on Islamic Economics and Finance for undergraduate students and beginners is not an easy task. This is because such a text has to cover all the important areas of economic theory as well as the topics relevant to money and banking, public finance, theory of distribution, development and growth etc. Here lies the real problem. In order to accommodate the most essential areas in a single volume, one has to be selective. How far the authors have been successful in achieving the goals; the assessment is left to the readers. We will welcome fruitful comments and suggestions, which will be taken care of in the next edition.

Prof. Mohd. Azmi Omar
Director General
Islamic Research and Training Institute
Preface

Introduction

Islamic Economics as a distinct discipline emerged in the last quarter of 20th century and the subject is now offered in many universities as part of the curriculum of Economics at the undergraduate and graduate levels. Although a few texts on introduction to Islamic Economics and Finance are available in the market, this book is the first of its kind and nature. Due to rigorous research in this area over the past 40-50 years, a vast body of literature is available by now in different areas of theory and policy. However, this voluminous literature is scattered in hundreds of thousand pages of different journals, books, and manuscripts. There are a significant number of institutions that cater for the cause of Islamic Economics and Finance, and beyond doubt IRTI is playing the pioneering role in this direction. These institutions organize and conduct conferences, seminars, symposium and workshops in different parts of the world and the material presented is often available in published form. However, access to this huge body of literature is much difficult for students, who are constrained to cover the prescribed course contents and syllabic within the limited time-frame of the semester. Further, the said body of literature comprises the views of renowned scholars and practitioners, expressed in technical language, and these views are sometimes contrasting due to differences in the approach and coverage.

As cited above, Islamic Economics and Finance is an emerging and yet expanding discipline, and as such, we do not have a paradigm. This state of affairs may be confusing for young students and general readers. In fact, it is not possible for anybody, even for the specialists in Islamic Economics, to digest all what is available in the literature. This book is an attempt to present the important fragments in one volume, to explain different concepts in simple words on which there is consensus among the scholars, and to bypass the differences of opinion at this level. How far this attempt has been successful is left to the opinion of the readers.

Audience

The book is designed for senior undergraduate students of Islamic Economics and Finance who have undergone intermediate level or advanced courses in micro and macro economics, money and banking, public finance and development economics etc. It is recommended that the courses on Islamic economic theory and policy as well as banking and finance be offered in the final year (7th/8th semester) of a 4-year bachelor’s degree program or equivalent. Since the conventional theory is also discussed in detail under the relevant topics, the material covered may be attractive and useful for students in other subjects like monetary and banking, public finance, development and growth, besides economic theory. Likewise, the graduate students in other areas of social sciences (like political science, history, sociology and education etc.), where introduction to economics is offered as an optional/elective course, may also find the book helpful. Equally, it may be informative for the general readers interested in having a first hand information on Islamic Economics, Banking and Finance, if they bypass the mathematical derivations and concentrate on the main theories and policies flowing through the text.

Approach

The book follows a comparative approach; that is, conventional theory and policy flow side by side with explanation of the concepts and framework of Islamic Economics & Finance. This
approach seems to be appropriate so that the students could comprehend the similarities and differences in the two streams and better realize the need for changes in the prevalent economic and financial set-up, particularly in Islamic countries. The main issue is how to mold the existing framework so that it is gets compliant with the divine injunctions or at least does not contradict with the basic rulings of Shariah.

As Islam encompasses all aspects of human life, Islamic Economics is bound to discuss all features of the economy and business. Here lies the main problem for a standard text on Islamic Economics & Finance. It must deal with theory (micro, macro and behavioral economics) as well as policy (monetary, fiscal, development, trade etc). Both the teachers and students would like to have a comprehensive text that covers all the areas of economics and finance. However, sorting out every essential topic from a vast body of literature and accommodating in a small text of limited scope is really a tedious and cumbersome task. Due to breadth and complexity of the task at hand, some inconsistencies and shortcomings are inevitable. No human effort in this world can be complete in coverage and perfect in attaining the objectives. The authors have attempted to do some justice with the objectives of the project, but never claim perfection. Only the time to come will disclose the prospects and failures.

**Organization**

The book is broadly divided into four parts. Part-I is meant to develop the basic concepts and comprises three chapters that briefly provide an overview of the foundations, methodology and goals of Islamic economics along with the Shariah guidelines for economic behavior.

Part-II is devoted to developments in Islamic Economics over the past 30-40 years. As stated above, the conventional economic theory is critically reviewed before discussing a topic in Islamic Economics. The first three chapters deal with micro-theory. For instance, Chapter-4 discusses the consumer behavior, Chapter- 5 deals with the theory of production and business organization and Chapter-6 tackles the important topics on the market structure. Chapter (7) is devoted to the theory of distribution that occupies an important position in Islamic Economic paradigm. The last three chapters cover some important topics in macro-theory. Chapter-8 gives an overview of the modern monetary theory. It tackles the institution of interest and the economic rationale for its prohibition in more detail. Chapter-9 discusses public finance in general with focus on the institution of Zakah and its economic implications. Chapter-10 presents an overview of the efforts made by Islamic economists in macro-modeling and discusses the problems and issues in this area of research. The advanced level material involving mathematical derivation is given in the appendices to the chapters concerned for the interested readers, taking care that the general flow of arguments is not affected.

Part-III is developed on the theoretical foundation presented in the preceding parts. It consists of six chapters that cover the working of a prototype Islamic economy in modern era and hints to the issues of practical importance. Chapter-11 discusses the salient features of an Islamic economic system whereas Chapter-12 gives a detailed description of the financial architecture of an Islamic economy in modern times. Different models of financial intermediation with diagrams and numerical examples are presented here to clarify the points. Chapter-13 carries forward the case of Islamic banking and monetary policy and evaluates the issues of practical nature. Chapter-14 is devoted to a detailed discussion of fiscal policy in an Islamic perspective. The feasibility of different fiscal instruments for an Islamic economy in modern era is tackled. The role of an Islamic State in formulating and implementing economic policies is discussed in some detail.
Chapter-15 gives an account of the policies and strategies for economic growth and development in conventional and Islamic perspectives. Chapter-16 finally provides a conceptual and strategic comparison of different economic systems prevailing in the world.

Part-II and Part-III are expected to cover the main crux of the argument. Part-IV is meant for the general information of the students. Chapter-17 gives a very brief historical account of the development of Islamic Economic Thought whereas the Chapter-18 discusses the economic performance of Muslim countries and concentrates on the issues and problems to which these countries are confronted presently. Some discussion of different international associations can also be found here with focus on the Organization of Islamic Cooperation (OIC).

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Islamabad, Pakistan

Dr. Hafiz M. Yasin

August 22, 2014

Dr. Atiq-uz-Zafar Khan
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Fundamentals of Islamic Economics and Finance

Islamic Economics as a distinct discipline emerged in the last quarter of 20th century and the subject is now offered in many universities as part of the curriculum of economics at the undergraduate and graduate level. Although a few texts on introduction to Islamic Economics and Finance are available in the market, this book is the first of its kind and nature.

Due to rigorous research in this area over the past 50-40 years, a vast body of literature is available by now in different areas of theory and policy. However, this voluminous literature is scattered in hundreds of thousands of pages of different journals, books, and manuscripts. There exist a significant number of institutions by now that cater for the cause of Islamic Economics and Finance, and, beyond doubt, the Islamic Research and Training Institute (IRTI) is playing the pioneering role in this respect. These institutions organize and conduct conferences, seminars, symposia and workshops in different parts of the world and the material presented is often available in published form. Obviously, access to this huge body of literature is much difficult for students, who are constrained to cover the prescribed course contents and syllabi within the limited timeframe of the semester. Furthermore, the said body of literature comprises the views of renowned scholars and practitioners, expressed in technical language, and these views are sometimes contrasting due to differences in the approach and coverage.

As cited above, Islamic Economics and Finance is an emerging and yet expanding discipline, and as such we do not have a paradigm. This state of affairs may be confusing for young students and general readers. In fact, it is not possible for anybody, even for the specialists in Islamic Economics, to digest all what is available in the literature. This book is an attempt to present the important fragments in one volume, to explain the different concepts in simple words on which there is consensus among scholars, and to bypass the differences of opinion at this level. A comparative approach to the mainstream economics has been followed throughout for better understanding of the concepts. How far this attempt has been successful is left to the opinion of the readers.

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