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ISLAMIC ECONOMICS SYSTEM: FROM PRINCIPLES TO MICROECONOMICS AND MACROECONOMICS FIELDS

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ABSTRACT

In mainstream economic textbooks, the term “economic principle” is often used to mean the fundamental law of economics, which is knowledge itself. However, in Islam, the source of knowledge is ultimately revelation i.e. divine guidance (*wahy*). Hence, the aim of this paper is to link the original sources of knowledge with microeconomic and macroeconomic theories. We identify fives principles of Islamic economics system that can be derived from the original sources, i.e., Allah determines right and wrong, principles of uses, principle of moderation, principles of freedom, and principle of justice. How are those principles being connected with in economic theories?

Keywords: microeconomics; macroeconomics; economic principle; Islamic perspective.

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1. INTRODUCTION

In mainstream economic textbooks, the term "economic principle" is often used to mean the fundamental law of economics, which is knowledge itself. In fact, these principles are the well-established economic theories that have passed through numerous tests. They have become economic laws that serve to guide the decision-making of consumers, producers, capitalists, workers, investors and government alike.

However, these economic laws (i.e. economic knowledge) are the product of the intellect *('aql)* alone with the scientific method to dictate what truth is. Although Islam acknowledges the role of the intellect (*'aql*) and sense experience as a source of value and knowledge, ultimately revelation i.e. Divine guidance (*wahy*) is put above them both.

In this regard revelation in Islam, becomes the primary source of economic principles with reason and experience playing the supportive role. The latter is popularly known as economic theory while the former is embodied in the economic system. This means that fundamental laws and regulations governing resource allocation fall under the realm of divine guidance. These fundamental laws are manifested in the Islamic economic system.[3]

In view of the above argument, one may ask - how are the economic principles connected to economic theories, i.e., both microeconomic and macroeconomic theories. Therefore, the aim of this paper is to link the original sources of knowledge with economic theories. But, before we are able to link it, we discuss first the principles underlying the Islamic economic system.

The rest of the paper is organized as follows. Section 2 reviews basic principle of Islamic economic system. Section 3 discusses microeconomics and macroeconomics fields from Islamic perspective. Section 4 concludes.

2. BASIC PRINCIPLE OF ISLAMIC ECONOMICS

The basis of Islamic economics is enshrined in the spiritual norms of Islam. Islamic economic is based on a paradigm which has socio-economic justice as its primary objective (Quran, 57:25)[4]. Unlike the modern economic systems which are based on the mundane philosophy, the Islamic economic system is directly guided by Allah Almighty Himself. As Islamic economic system was passing through its early stages of development, the Quran guided the Holy Prophet (P.B.U.H.) with regard to its effective enforcement. Since this system is Divine guided, it is spiritual. Additionally, all important aspects of the Islamic economic system and the applicable norms are thoroughly discussed in the Holy Quran. Whether it is production, consumption, distribution or the financial system, they all have been discussed in this Divine Book sufficiently. Quran itself declares that Allah Almighty created the human being as His Viceroy on this Earth, and as such He created all needed provisions so that they may consume them and may satisfy their wants. He declares, "O! you human beings, pray your own Lord (The Nourisher) who created you and those before you (i.e. the Genies) so that you may fear Him. It is He Who made this Earth as a bed for you and the sky as a canopy for you, and He causeth the rain and creates different types of fruits v and corns from it, so that you may consume them (as your provision). Hence, do not make any copartner with Him; and you know it better. (Al-Baqarah: 21 and 22).

Some of the principles of the Islamic economic system, as laid down by the Qur'an and the Sunnah, are discussed as follows:

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[3] Here, we define Islamic economics as both a science and an art which deals with the daily routine of a Muslim's economic life i.e. how he earns his income and how he spends it. It is a science in the sense that it involves many scientific methods in the production of material goods, their distribution and consumption.

[4] For some details related to the paradigm see Chapra (1992).

a. Allah determines Right and Wrong

Islamic economic system should principally, first, makes distinction between what is permitted being lawful (Halal) and what is forbidden being unlawful (Haram), also harus, compulsory and makruh. To determine what is permitted or lawful (Halal) and what is forbidden or unlawful (haram) is the soul prerogative of God. None but God is empowered to pronounce what is right and what is wrong. Allah has made demarcation between lawful and unlawful in the economic sphere and has allowed man to enjoy those food items and other articles of use which are lawful and avoid those things which are unlawful.

Allah says: "O ye who believe ! Forbid not the good things which Allah hath made lawful for you, and transgress not, Lo! Allah loveth not the transgressors. Eat of that which Allah hath bestowed on you as food lawful and good and keep your duty to Allah in Whom ye are believers." (5 : 87-88)

No human being has power to say what is right (Halal) and what is wrong (Haram). The Qur'an clarifies this principle in unambiguous terms when it commands: "And speak not concerning that which your own tongues qualify (as clean or unclean), the falsehood: "This is lawful, and this is forbidden", so that ye invent a lie against Allah…" (16:116)

b. Principles of Uses

Within the bounds of lawful (Halal) and unlawful (Haram) prescribed by Allah and also keeping in view the rules of moderation and prudence, the man has been allowed to make full enjoyment of God's gifts bestowed on him.

The Qur'an says: "O mankind! Eat of that which is lawful and wholesome in the earth, and follow not the footsteps of the devil. Lo! he is an open enemy for you." (2:168). At another place, the revealed book of Islam states: "So eat of the lawful and good food, which Allah hath provided for you, and thank the bounty of your Lord if it is Him ye serve……." (16:114).

However, the principle of use should not be over stretched so as to indulge in extravagance and wastage of economic resources. The Qur'an brings home this point when it addresses mankind: "O children of Adam ! Look to your adornment at every place of worship, and eat and drink, but be not prodigal Lo! He (Allah) loveth not the prodigals."(7:31)

All things have been created by Allah for man's use and service. To restrain oneself or forbid others from the enjoyment of lawful items of food and other articles of use tantamounts to renouncing the blessings and favours of Allah which has been strongly condemned. The Qur'an prohibits it in very clear words when it says : "O ye who believe! Forbid not the good things, which Allah hath made lawful for you, and transgress not, Lo! Allah loveth not transgressors."(5:87). In another verse, the Holy Qur'an questions those who put restrictions on the use of certain things without divine sanction: "Say! Who hath forbidden the adornment of Allah which He hath brought forth for His bondmen, and the good things of His providing?….."(7:32). Thus the Qur'an has disapproved the ways of monks and ascetics who consider the satisfaction of physical urges an obstacle in spiritual development.

c. Principle of Moderation

Islam unequivocally discourages its followers to cross the limits and follow extremes. The Muslims have been called by the Qur'an a middle nation (2:143). Therefore, the principle of moderation carries paramount importance especially in the economic field. This principle is followed by the true believers in the production of wealth as well as in the consumption and spending of wealth. Although earning of wealth through permitted (Halal) means is allowed, yet the piety demands that a Muslim should not become mad after amassing wealth like a greedy materialist. He should exercise restraint and earn wealth to meet his lawful needs. Extra wealth, if at all is earned by him somehow, may be spent in the path of Allah on charity and relief of the poor. Similarly, in the consumption and spending of wealth, the believer is recommended to strike balance avoiding miserliness and extravagance. Miser is he who does not even provide for the legitimate needs of himself and his family let alone spending on charitable and noble causes. Extravagant or spend thrift is a person who squanders his wealth in luxury, gambling, drinking, and on lavish expenditure on festivities, weddings, day to day living. Islam condemns both miserliness and extravagance and enjoins upon a believer to exercise moderation. The Qur'an appreciates those who exercise moderation in spending when it says: "And those who, when they spend, are neither prodigal nor grudging; and there is ever a firm station between the two."(25:67)

d. Economic Freedom

Every individual, according to Islam, is accountable for his actions done in this world. He would be rewarded for his good actions and punished for his evil actions in the hereafter. Accountability for individual's actions is meaningless if the individual is not provided reasonable freedom to act independently. Therefore, Islam puts highest value on individual's freedom of action in every field of human activity such as social, political, economic religious, moral, etc.

Islamic principle of economic freedom means that an individual has been allowed liberty by God to earn wealth, own it, enjoy it and spend it as he likes. It also entails freedom to adopt any profession, business or vocation to earn livelihood. But Islam has not allowed unlimited freedom in the economic sphere. As we have already discussed, Islam makes distinction between Halal (lawful) and Haram (unlawful). In the field of production, distribution, exchange and consumption, only Halal (lawful) means are permitted. Remaining within the restrictions of Halal and Haram, an individual enjoys full freedom to earn and spend wealth as he likes. Thus Islam recognises free enterprise, human initiative, and individuals potential. It also recognises role of organisation, capital, labour and market forces in economic field. No unnecessary curbs are placed on the individual or the organisation regarding earning or owning of wealth. No upper limit or ceiling is imposed on properties or holdings. Besides restrictions of Halal and Haram, other restrictions are rarely placed on economic activities, prices of goods, ownership or on monopolies unless the same are really necessary for safeguarding the common interest of Muslim community.

e. Principle of Justice

Islamic principle of justice operates in every sphere of human activity, may it be legal, social, political or economic. Islamic economic system, in fact is based upon the principle of justice which governs all the basic aspects of economy like production, distribution, consumption and exchange.

In the sphere of production, Islamic principle of justice ensures that nobody is exploited by the other and that nobody acquires wealth by unjust, unfair, unlawful and fraudulent means. The followers of Islam have been allowed to acquire wealth through just and fair means. Islam admits the right of every individual to earn his livelihood, to acquire wealth, to own property and live a comfortable life. But it does not allow that people should amass wealth through bribery, corruption, embezzlement, stealing, robbery, gambling, trade in narcotics, exploitation, gambling, interest, fraud, hoarding, black marketing, prostitution, malpractices in business, immoral professions or through other unjust methods.

In the field of distribution, the Islamic principle of justice plays the most vital role. One of the greatest contribution of Islam to humanity is that Islam ensures just and equitable distribution of wealth among the people. Justice in distribution, which is called by various names like economic justice or social justice or distributive justice, demands that economic resources and wealth should be so distributed among the members of the community that on the one hand the gulf between the rich and the poor should be bridged and on the other hand everyone should be provided with basic necessities of life. Islam discourages concentration of wealth in few hands and ensures its circulation in the community not only through moral education and training but also through effective legal measures. System of Sadaqat, Zakat and voluntary alms along with laws of inheritance helps distribution of wealth among the larger sections of society,

3. MICROECONOMICS AND MACROECONOMICS FIELDS FROM ISLAMIC PERSPECTIVE

Having discussed the basic principles of Islamic economics, then the next questions how do we link these principles with two important fields in economics, i.e., microeconomics and macroeconomics? Before, we get the answer, let we look the current thinking about those fields.

Currently, the primary textbook could easily make a distinction between microeconomics ("small" economics), which examines the economic behavior of agents (including individuals and firms) and macroeconomics ("big" economics), addressing issues of unemployment, inflation, monetary and fiscal policy for an entire economy.

However, the free encyclopedia (or in short Wikipedia) defines both microeconomics and macroeconomics as follow:[5]

Microeconomics looks at interactions through individual markets, given scarcity and government regulation. A given market might be for a product, say fresh corn, or the services of a factor of production, say bricklaying. The theory considers aggregates of quantity demanded by buyers and quantity supplied by sellers at each possible price per unit. It weaves these together to describe how the market may reach equilibrium as to price and quantity or respond to market changes over time. This is broadly termed supply and demand analysis. Market structures, such as perfect competition and monopoly, are examined as to implications for behavior and economic efficiency. Analysis of change in a single market often proceed from the simplifying assumption that behavioral relations in other markets remain unchanged, that is, partial equilibrium analysis. General-equilibrium theory allows for changes in different markets and aggregates across all markets, including their movements and interactions toward equilibrium.

Macroeconomics examines the economy as a whole to explain broad aggregates and their interactions "top down," that is, using a simplified form of general equilibrium theory. Such aggregates include national income and output, the unemployment rate, and price inflation and sub-aggregates like total consumption and investment spending and their components. It also studies effects of monetary policy and fiscal policy. Since at least the 1960s, macroeconomics has been characterized by further integration as to micro-based modeling of sectors, including rationality of players, efficient use of market information, and imperfect competition. This has addressed a long-standing concern about inconsistent developments of the same subject. Macroeconomic analysis also considers factors affecting the long-term level and growth of national income. Such factors include capital accumulation, technological change and labor force growth.

Based on the above definition, we will discuss both fields from Islamic perspective separately (although both cannot be separated):

a. Microeconomics Field

i. Market Structure

Market is one of the main institutions of the Islamic economic system. Limited collusion, limited profit, nonexistence of monopoly[6] and monopsony and being moral can be mentioned as characteristics of Islamic market. According to these characteristics, moral and government are two main and effective factors for market control. Moral and faith cause the supply of and demand for goods and services to be in agreement with the public interests. Government makes control and intervenes, if necessary, in the market in order to support the natural and equilibrium prices not to be unfair, but to be in

[5] Refer to http://en.wikipedia.org/wiki/Economics

[6] Ma'mar reported Allah's Messenger (pbuh) as saying: "He, who hoards is a sinner." It was said to Sa'id (b. al-Musayyib): "You also hoard." Sa'id said: "Ma'mar, who narrated this hadith also hoarded."

agreement with the public interests. The history of Muslims shows that Islamic governments pay attention to the market mechanism and price system.

The market process is not the only way of getting things done in the context of need fulfillment, economic growth or the other goals we cherish in life. Nevertheless it is of primary importance in a society with private property and freedom of contract. The Islamic institutional arrangement recognizes the central importance of the market process and allows it to work subject to the goals of the Islamic economy (Siddiqi, 2005).

However, as argued by Tuma,[7], the government should have only a limited role in the productive process, in market structure and in the movement of prices. As reported by Anas: During the life time of the Prophet (pbuh) price level went up. They (people) said: “Messenger of Allah (pbuh)! Fixed the prices for us.” On this he (the Messenger of Allah, pbuh) said: “Prices are fixed by Allah. He contracts and expands the sources of livelihood. And I hope to meet my Sustainer (God) in a state that no one may raise a claim of injustice against me in respect of blood or money.”

Ibn Taimiyyah had also discussed the issue of market structure. In his discussion, monopoly and monopolization practices by limiting supply of goods and services. He argued strongly against monopolistic practices, which amounts to favor a competitive market structure to ensure fair prices for the people.

ii. Theory of Price

The price theory in the microeconomic analysis is implicit in the writings of Ibn Taimiyyah. In his detailed discussion on price control, Ibn Taimiyyah has analyzed how prices are determined in the market by the interplay of demand and supply forces. According to him, prices could increase due to the shortage of supply of the commodity in question and also because of higher income of the people. The former gives the concept of the leftward shift in supply curve with a resulting increase in prices, while an upward shift in the demand curve due to rise in income (or the income effect) is reflected in the latter. The ideas of movement along and shift in demand and supply curves are thus implicit in the analysis of Ibn Taimiyyah.

Ibn Taimiyyah presented a concept of "equivalent price", defined as the price determined by the market forces in a competitive market structure without coercion, fraud, monopolistic behavior, hoarding and other corrupt practices, a price which is satisfactorily acceptable to both the transacting parties. Any other price, which exists due to market imperfections, will affect human welfare, and hence calls for government intervention and, if necessary, price control.

In Ibn al-Qayyim's analysis, determination of prices should also be left to the market forces, i.e., the demand and supply forces, as long as imperfections, distortions and monopolistic behaviour do not affect public interest. Otherwise, he recommends government intervention for fixing market prices. Hence, Ibn al-Qayyim and Ibn Taimiyyah treat both commodity and factor markets similarly in the context of pricing

In addition, a variety of aspects of pricing has been introduced to produce a dynamic pricing activity. Since, Islamic banking is a term that reflects financial activities, which do not contradict to Shari’ah principles. These principles would be translated into practical operations especially on the price determination of those products. In this section, we will discuss several options of price determination (Abdul Ghafar et. al.,2010).

[7] See, Tuma, E. (1965) Early Arab Economic Policies. Islamic Studies 6(1), 1-23.

b. Macroeconomics Field

i. Macroeconomic Facts

The facts started from the story of Prophet Yusuf in Chapter Yusuf, verses 42-48.[8] The Pharaoh of Egypt summoned Prophet Yusuf, then an imprisoned slave, to interpret two dreams. In the first, seven plump cattle were followed and devoured by seven lean, starving cattle. In the second, seven thin ears ate full ears of corn. After hearing these dreams, Prophet Yusuf prophesied that Egypt would enjoy seven years of prosperity, followed by seven years of famine. He recommended a consumption-smoothing strategy to provide for the years of famine, under which Pharaoh would appropriate and score a fifth of the grain produced during the years of plenty. According to the tafseer ibnu Khathir, Pharaoh embraced this plan, made Prophet Yusuf his finance minister, and thereby enabled Prophet Yusuf to save Egypt from starvation.

According to tafseer ibn-Abbas, he elaborated further verses 46 as follows:

When he went to him, he said: (Joseph! O thou truthful one!) O you who were truthful in interpreting the first dream, (Expound for us the seven fat kine) that came out of the river and (which seven lean) that were dying of lack of nourishment (were eating and the seven green ears of corn and other (seven) dry) coiling around the seven green ears, overshadowing their greenery, (that I may return unto the people) to the king, (so that they may know) the interpretation of the king's dream. Joseph said: "Yes! I will interpret his dream. The seven fat kine are seven years of soil fertility, and the seven green ears represent abundance and low prices during these seven years. The seven dying, lean kine represent years of drought while the seven dry ears represent lack of foodstuff and high prices during these years".

While verse 47, ibn-Abbas mentioned that:

Joseph then instructed them what to do. (He said: Ye shall sow seven years as usual) each year continuously, (but that which ye reap) of crops, (leave it in the ear) and do not thresh it, this is better for its preservation, (all save a little which ye eat) all save the quantity which you need for your sustenance.

He further explained in verse 48 that:

(Then after that) after the seven years of soil fertility (will come seven hard years) seven years of drought (which will devour all that ye have prepared for them) all that you have saved during the seven years of soil fertility, (save a little of that which ye have stored) kept aside.

Based on the above evidence (naqli), although sometimes our mind says we can avoid it for some reason (for example, policy prescriptions proposed by novel laureate or very sophisticated forecasting tools). But, if it happens, we could consider as testing times, driving up prices, straining relationships, affecting families, removing comfort, leading to despair, and revealing character

ii. The Life-Cycle Model of Consumption

[8] Scholars, such as ibnu Khathir place the episode somewhere around 1800 B.C.

The Chapter Yusuf verses 42-48 can also explain the life-cycle model of consumption. The model is the standard way that economists think about the inter-temporal allocation of time, effort and money (as capital). The framework has a venerable history in the economics profession, with roots in the infinite horizon models (including our life hereafter) and the finite horizon models. Developments since the 1950s have considerably increased the breadth, depth and coherence of the framework so that the modern version provides a guide to thinking about the modeling of many life-cycle choices—such as consumption, saving, education, human capital, marriage, fertility and labor supply.

Prophet Yusuf recommended a consumption-smoothing strategy to provide for the years of famine, under which Pharaoh would appropriate and score a fifth of the grain produced during the years of plenty. According to the tafseer ibnu Khathir, Pharaoh embraced this plan, made Prophet Yusuf his finance minister, and thereby enabled Prophet Yusuf to save Egypt from starvation.

Why did Prophet Yusuf recommend storing the grain (a form of domestic investment yielding a rate of return of zero before depreciation) rather than lending it broad at a positive rate of return? Thus storing the grain at home was a much safer course. More importantly, the saving decision for later consumption is considered as effective strategy.

In its most general formulation, the life-cycle framework simply asserts that agents make sequential decisions to achieve a coherent (and "stable") goal using currently available information as best they can. This view does not rule out many models which would not be consistent with earlier restrictive models in the life-cycle tradition (such as certain variants of the permanent income model). For example, we would certainly include within the framework the "buffer stock" model which assumes that agents cannot borrow and that they are impatient, even though this predicts much more tracking of consumption with income than earlier permanent income models can accommodate. More generally we would not rule out, a priori, that life-cycle behavior can include potentially important features such as habits, imperfections in capital markets, disagreements between husband and wife about how much to save, limited computational powers, and discounting of the future that changes over time. We would, in fact, go even further and include under the life-cycle framework, for example, models that do not assume expected utility so as to allow that agents may have a preference for the early or late resolution of uncertainty even when this does not confer any planning advantages. What the life-cycle framework does rule out is "rule of thumb" behavior, in which households simply spend a fixed fraction of their income.

iii. Investment

The introduction of Islamic banking stems from the fact that Islam prohibits interest (*riba*) and encourages trade (*bay'*) and partnership (*Shirkah*). Its role is to produce a viable alternative to the interest-bearing banking system. Parting itself from interest, Islamic bank encourages profits from *bay'* (trading & commerce) which are created via mutual trade and cooperation, while by means of profit-sharing and risk, profits are created through the demand-driven equity investment (*mudharabah and musharakah*). The latter can promote productivity and creativity as it is directly involved in real production and the provision of value-added goods.

Therefore, the role of Islamic banking industry is vital to generate productivity and consequently on the economic performance. Their role in providing funds and hence, fostering economic development with the innovative entrepreneurship as the critical element. Islamic banks play a pivotal role in economic development because they choose which firms get to use rabbul mal's funds. According to this view, the Islamic banks adjust the path of economic progress by affecting the allocation of capital and by receiving a favorable profit rate from firms. As a consequence, this view of finance and development highlights the useful impact of Islamic banks financing on economic performance.

As opposed to conventional finance, where interest represents the contractible cost for funds tied to the amount of principal over a pre-specified lending period, the central tenet of the Islamic banking system is the prohibition of riba, whose literal meaning "an excess" is interpreted as any unjustifiable increase of capital whether through loans or sales. The general consensus among Islamic scholars is that riba covers not only usury but also the charging of interest and any positive, fixed, predetermined rate of return that are guaranteed regardless of the performance of an investment (Iqbal and Tsubota, 2006; Iqbal and Mirakhor, 2006; Iqbal and Llewellyn, 2000). Since only interest-free forms of finance are considered permissible in Islamic banking, financial relationships between financiers and borrowers are governed by shared business risk (and returns) from investment in lawful activities (halal). Islamic law does not object to payment for the use of an asset, and the earning of profits or returns from assets is indeed encouraged as long as both lender and borrower share the investment risk together. Profits must not be guaranteed based on assumption and can only accrue if the investment itself yields income. Any financial transaction under Islamic law assigns to investors clearly identifiable rights and obligations for which they are entitled to receive commensurate return.

iv. Production of Wealth

In order to fulfill the daily needs and requirements, Islam permits the Muslims to produce and manufacture such things which are quite essential for human lives. For the production of consumer goods the combination of land, labour, capital and organisation has been approved by Islamic economics. Quran and hadith, both speak highly about the human labour for producing things beneficial for the Muslims and the Muslim society. A great dignity has been ascribed to human labour in Islam. It discourages idle life and wastage of time in useless pastimes. But it encourages healthy pastimes and professions like daily exercise, wrestling, recreation and tournaments and many other similar activities.

Therefore, in Islam, labour that comprises work, intellectual as well as physical, is considered the basis of all richness and property.[9] There is both a right to work and a right to the product of that work, as well as a right to benefit from the rewards of divine providence. Work must always have an ethical-moral component, either in itself or in its outcome (i.e., charity, contributing to the community, etc.). There is in the philosophical sense no intrinsic wealth, although the right of inheritance is protected and specifically prescribed under Sharia, which allows for the preservation of property, its devolution and accumulation. Nonetheless, there is the implied premise that wealth should be legitimized through work. In addition, wealth must also be used for good of others, such as the needy, and for the community as a whole. The greater one's wealth and power, the greater is the responsibility to use them properly. In many respects work is considered a form of piety.

v. Distribution of Wealth

Perhaps in no religion of the world, the distribution of wealth has been emphasised so much as in Islam. Islam disdains poverty in any form chiefly because man has been created on this earth as a viceroy of Allah, and. He does not like His viceroy or his progenies should pass poor life. But it was the kings, monarchs and the capitalists who took possession of all resources of production and left the people to become impoverished.

At the time of Islamic revolution, there was much poverty throughout the world including Arabia. It was due to this fact that Allah ordered not only to the Muslims but also to the pagans to spend their wealth on poor. There are many verses in the Holy Quran to this effect. "Establish prayers and pay Zakat", is a Divine order repeated more than as other order in the Holy Quran. In the same way the Muslims have always been prompted to spend on the poor and the needy. "They ask thee, what should they spend?" "Say, whatever is left after your (genuine) expenditure." (spend them on your other brethren).

In Islam, the Muslims have been asked to pay to the Islamic Government in the following forms so that the wealth may be spent on the poor and the needy and on State affairs. These items are the booties, Fai, Zakat, Sadaquat, Ushr, Khums and other taxes. In Surah Tauba, Allah Himself has ordained to distribute Zakat proceeds on eight items, i.e. the poor, the paupers, the collectors of Zakat, those new Muslims whose hearts are to be reconciled, the; slaves, the insolvent debtors, in Jihad and for the travelers. (Surah Tauba, V. No. 60). The non-Muslims have also been ordered to pay to the Islamic government Kharaj, Jizya and Oshoor on their merchandise. They are also bound to pay to the government other

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[9] Inter-face generation

taxes at time of need. In the same way the Muslims are also asked to pronounce their wealth as Waqf (Trust) in the way of Allah (which will be spent on the poor and the needy). Their wealth is also subject to further distribution as inheritance among their heirs after death. All these facts clearly show that Islam does never want the concentration of wealth in a few hands rather it wants that it should remain rotating in the whole society so that everyone be saturated from it. The hoarders of wealth have greatly been warned with severe punishments in the Quran.

vi. The Financial System

Islam as a last ideology (religion) for the whole mankind could not have ignored this most important: aspect of human life. It was due to this fact that the Prophet (pbuh) gave to the Muslims the unparalleled financial system of Bait-al-Mal which was to dominate all economic activities of the Muslims throughout the world. The institution of Bait-al-Mal was already established by the pious hands of the Prophet (pbuh) before the battle of Badr. Ibnu Kathir declares, in his famous exegesis, that Saad-bin-Malik, a companion of the Prophet (pbuh) found a sword in the battle of Badr. He brought this sword to the Prophet (pbuh) and requested that the same may be given to him. The Prophet (pbuh) replied that the sword did not belong to him nor to the companion. He should deposit it in the Bait-al-Mal. The sword was deposited there. (Tafseer-Ibnu Kathir, Surah Anfal). This clearly shows that the institution of Bait-al-Mal was already established during the Prophet's (pbuh) time, though no especial edifice was built for that. It was Masjid Nabawi (The mosque of the Prophet (pbuh) which served this purpose. The main sources of income of Bait-al-Mal, at that time, where (1) Khums, i.e. the fifth part of the booties of battles, (2) Fai, (3) Zakat, (4) Sadaquat, (5) Ushr, (6) Kharaj, (7) Jiisya, (8) Ransom money, (9) the Khums of Treasure Trove, (10) the income of Waqf and the (11) contribution of the Muslims at time of need. The income of Bait-al-Mal thus collected was spent on the poor, the paupers, slaves, Mujahedeen and State affairs.

In this way the entire function of the Islamic Government was financed from the sources of Bait-al-Mal. In order to control the monetary system the Prophet (pbuh) had permitted bimettalism in the Islamic State. In this way the coins of all countries were in free circulation in Arabian market. No special coin was minted at that time. It was done during the reign of the second Caliph. The real functions of Bait-al-Mal were also evinced during his reign where all the State affairs were carried through this august institution.

The above macroeconomic facts and issues have created several fields in macroeconomics. In the following discussion, we will touch on monetary economics and public finance as example.

(i) Monetary Economics

Some early Muslim thinkers addressed the issues of money and monetary economics. For example, Ibn Miskawaih's (1030AD) discussion of exchange incorporates the function of money as the medium of exchange. He also subscribes to gold standard.

Then, Al-Ghazali (1058-1111 AD) discussed money and its functions. He analysed two im'portant functions of money: medium of exchange and standard of value. An important observation of his is that these functions of money get disrupted when people demand money for money's sake.

It is interesting to note that the idea contained in what is known in the contemporary literature as the Gresham's law was discussed explicitly in the work of Taqiuddin Ahmad al-Maqrizi in the 14th century. The law simply says that the bad money drives away the good money from the market, since people tend to use bad money for transactions and save the good money, and thus the good money disappears from the market. Al-Maqrizi found this happening in Egypt and analysed the phenomenon. Ibn Taimiyyah (1263-1328 AD) also discussed the same law. The credit for this contribution in the western literature goes to Thomas Gresham, an author of the nineteenth century.

Al-Maqrizi also argued for gold standard, more specifically the gold and the silver bullion, although he perceived the eventual. need for the use of other money. He also related money supply with inflation rate (rise in prices), an idea which was refined later and explained by a theory known as the Quantity Theory of Money. The history of conventional economic thought relates these ideas on the monetary economics to the classical economists, centuries after al-Maqrizi.

As it has been analysed even in some of the contemporary conventional literature, interest is the root of many evils including economic fluctuations leading to inflation and depression, income inequality and so on. The Islamic economics is unique in its total prohibition from the monetary system. Besides its prohibition in the basic Islamic sources, many Islamic scholars analysed various kinds of interest, explicit and disguised (see, for example, Ibn al-Qayyim), and their prohibitions, although serious analysis of its socio-economic implications is a more recent phenomenon.

(ii) Public Finance

It has two major dimensions: public revenues and public expenditure. The early Muslim writers dealt with both of them. Some of them analysed the taxation source of public revenue and its related issues. For example, Abu Yusuf (731-798 AD) argued for a proportional tax in agriculture, instead of a fixed levy on land, on the ground that the former was likely to yield larger revenue and facilitate expansion of land area under cultivation. He argued for following the principles of justice and equity in taxation.

In public expenditure, Abu Yusuf provided guidelines for developmental expenditure including irrigation projects, transport system (bridges) and so on. In this context, he emphasised the Islamic moral code of behaviour of the government while dealing with public money. According to him, this is a trust from Allah which will be accounted for, and hence the government should behave accordingly.

Abu 'Ubaid (838 AD), Mawardi (1058 AD) and many others discussed the sources of government revenues, norms of their collection and the Islamic values in their expenditure.

Abu Bakr al-Tartusi (450 AH) provided the concept of the ability to pay in the principle of taxation, that tax should be imposed only on the surplus income after meeting all the basic needs, since those who do not have surplus are not able to pay taxes. Explicit in this is the idea of minimum taxable income such that any income below this is exempted from tax; and implicit in this is the seed of the ability to pay approach in the principle of taxation. Abu Bakr al-Tartusi also emphasised the need for justice and benevolence in the collection of taxes, without resort to oppression, injustice and injury to the taxpayers. In public borrowing, al-Ghazali (1058-1111 AD) saw its permissibility when other regular sources of revenues of the state are not adequate to meet expenditure on defence, etcetera.

Ibn Khaldun (1332-1404 AD) provided positive analysis of the effect of tax on work efforts. According to him, work efforts will be affected by high taxes resulting in a decrease in production and population (due to emigration), which will eventually decrease tax revenue by decreasing the tax base. He argued for demand management policy in the form of 10weI: taxes and higher government expenditure during recession, which idea is conventionally believed to come out of Keynes' General Theory in about mid-20th century.

Al-Maqrizi (1364-1442 AD) analysed the problem of tax burden. If tax is not efficiently handled, tax burden may be shifted to consumers, whereas it is supposed to be borne by the producers and businessmen from the profit income. A consequence is the fall in demand for. the goods concerned because of their higher tax adjusted prices, which in turn affects the suppliers and the economy as a whole.

In public expenditure, al-Tartusi emphasised development and provision of physical infrastructure and public goods (and also subsidising the basic needs for human welfare). Al-Maqrizi analysed budget, budget preparation including the collection of necessary background data and discussion on other budget matters, which pertain to the functions of diwan (council). He also discussed the issues related to its implementation, supervision and control by the institutions like Diwan al-Muhasabah and diwan for investigation.

(iii) Economic Development

As against the sufis, most of the Islamic writers emphasised the economic achievements, within the Islamic norms, for human welfare in this world and in the hereafter. The advantage of wealth (or economic development) is that it enables one to lead a good Islamic life performing all Islamic obligations including hajj, jihad, zakah (Ibn al-Qayyim), and it leads to national strength, stability and national defence (al-Tartusi). Al-Tartusi indicated to a phenomenon which the contemporary world has been facing; economic backwardness leads to political instability, poor national defence, politico-economic dominance of the super power; and, on the other hand, economic power leads to political strength, control, dominance and external security of a nation. The intellectual mind of al- Tartusi could clearly perceive this phenomenon and hence advised the Muslims to achieve economic progress within the Islamic values.

Ibn al-Qayyim put a lot of emphasis on agricultural development. In view of the fact that there exist people who own land but do not or cannot cultivate it, and there are others who are able and willing to cultivate land but .do not have it. Ibn al-Qayyim supports the arrangement of sharecropping in the agricultural sector. According to him, it is fair that some provide land and others cultivate it, and they share in output on an agreed basis. There is, however, a debate among the jurists whether sharecropping is allowed or not. According to the recent economists of the third world, sharecropping is not a good arrangement of land use in the agricultural sector.

Ibn Taimiyyah (1263-1328 AD) emphasised that everybody must be guaranteed a minimum standard of living in order to be able to perform his obligations to his family, fellow people as well as duties to the Creator. He assigned a religious status to economic activities leading to economic development by stating that agricultural, industrial and commercial activities that are necessary for satisfying basic needs of the people are fard kifayah.14 One of his most important economic contributions is to emphasise the government's responsibility to guarantee fulfilment of basic needs to everybody.

In economic development, the basic needs approach is a recent development. Ibn Hazm, however, raised the issue of basic needs in the 11th century (994-1064 AD). According to him, basic needs consist of food, drink, clothing and shelter. Ibn Hazm assigns to the government the responsibility to guarantee basic needs of the poor. He also emphasized the role of the rich in this matter.

Shah Wali Allah (1703-1762 AD) analyses the adverse effect of high inequality in the distribution of income. To him, income concentration leads to production of luxuries in the society which causes a socially undesirable product mix, increasing sufferings of the poor.

One of the crucial factors in economic development is the saving or investment process. In conventional economic systems, the interest rate mechanism is at the heart of that process, however an Islamic financial system cannot rely on that mechanism (Iqbal et. al., 2005). With this fact considered, more research about explores the role and significance of Islamic financial system, instruments and institutions in economic growth and development, both theoretically and empirically.

(iv) Institutional Economics

Institutional economics is an economic perspective that attempts to extend economics by focusing on the social and legal norm and rules that underly economic activity. In the economic activities, law and economics (especially finance) are inter-related. Law is argued as set of contracts. These contracts are defined, and made more or less effective by legal rights and enforcement mechanisms. From this perspective, a well functioning legal system facilitates the operation of both markets and intermediaries. The operation would overall affect the level and quality of financial services which finally improve the efficient allocation of resources and economic growth.

Although, Islamic law has been in existence for more than fourteen hundred years, but its implementation have been subjected to the willingness of the rulers in the passage of history and civilization. Although, the study on financial contracts has been extensively reviewed, the role of Islamic contracts is not highlighted, except those in the historical institutional and contract theory literatures. For instance, the discussion on risk-sharing in financial contracts with focus on the sea-loan (debt-based) contract and commenda (equity-based or mudharaba) contract. Whereas The Mejelle Ahkame Adliye[10] was elaborated between 1869 and 1876 as a part of the Legislative purpose of the *Tanzimat*, initiated in imperial Turkey, with the approval of Sultan (Rahman, S.A, 1967), has been in the market since the late of nineteenth century but not implemented due to colonial era which forced the colonialized countries to follow their laws, e.g. common law in Malaysia[11] and Dutch law in Indonesia.

Since, Islamic teachings covers all dimensions of human life includes guiding the relations among people as individual and as a communal in various aspects such as economic, social, cultural and political. Accordingly Muslim individual cannot compartmentalise his/her behaviour into religious and secular dimensions as he/she is always asked to be bound by shari'ah. Islamic law thus embodies an encompassing set of duties and practices including worship, prayer, manners and morals, marriage, inheritance, crime and commercial transactions: that is, it embraces many aspects that would not necessarily be considered as law elsewhere (Lewis and Alagoud (2001).[12] Based on this fact therefore Islamic teachings on transactions may have a strong distinctive character in the economy provided that they are implemented properly taken into account all necessary spirit, rules, regulations, and institutions.

The fact that under Islamic law on transactions there are various types of contracts, from contract of sales and purchases, contract of usufructs such as leasing, contract of sharecropping, partnerships and equity participation, and Islamic banking establishments, emerged significantly in the last three decades, are permitted to adopt all these contract types, then it is logical to classify Islamic banks into a universal banking institutions.

Most importantly the aspect of contracts as foundation for the distinctive Islamic financial products, i.e. the one resembling profit-loss sharing nature which contains cooperative spirit, will be analysed to establish a strong connection with financial stability as pre-requisite to achieve the economic growth. It is believed in this paper that embarking from cooperative spirit, through developing equity partnership instruments in the financial system, will be able to create a more sound value added in the economy, so that higher economic growth and more equitable distribution of resources can be achieved simultaneously.

4. CONCLUSIONS

The main aim of this paper is to link the original sources of knowledge with microeconomic and macroeconomic theories. From the original sources, we could identify fives principles of Islamic economics system, i.e., Allah determines right and

[10] The Penal Code of 1850 and the Commercial Code of 1861 were the predecessors of the Mejelle but these two compilations had been largely based on the laws of European countries. The Mejelle represents an attempt to codify that part of *Hanafi fiqh* which treats of *muamalat* (transactions between people). The codification was the work of a Commission of Jurists, headed by Ahmad Djevdet Pasha, the Minister of Justice (Rahman, S.A, 1967).
[11] For example, the Company Act 1965 does not make the payment of zakat as compulsory.
[12] Lewis, M.k., and Algaoud, L.M., (2001), *Islamic Banking*, Edward Elgar

wrong, principles of uses, principle of moderation, principles of freedom, and principle of justice. Then, the economic theories could be presented if the principles are adopted.

TABLE 1: PRINCIPLE AND THEORIES: A MATCHING PROCESS

Theory	**Sub-Theories**	**Principle**	**Agents**	**Economic Behaviour of Agent**
Microeconomics	Market Structure	Demand and supply Prices Wealth Income	Commodity	Dynamics Honest Trust Fairness
	Theory of Price	Wright and Wrong Uses Moderation Freedom Justice	Consumer Producer Government	Extravagance Basic Needs Deviation
Macroeconomics	Macroeconomic Facts	Economic cycle (Surah Yusuf: verses 42-48)	Policy Government	Forecasting tools
	The Life-Cycle Model of Consumption	Financial plan Financial assets	Income Saving Withdrawals Retirement	Budget constraint Securities Risky
	Investment	Prohibits interest Encourages trade Partnership	Profit-sharing Risk-sharing	Productivity Consequently
	Production of Wealth	Time period	Land Labour Capital Organisation	Rightfully
	Distribution of Wealth	Human intervention Rich Poor	Resources	Practicable system
	The Financial System	human life Islamic law	Goods Services	Control Monitor Supervise

Source: Authors’ compilation.

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