

▷ Islamic Moral Economy Foundations of Islamic Finance

Dr Mehmet Asutay

Professor in Middle Eastern and Islamic Political Economy & Finance

Director, Durham Centre for Islamic Economics and Finance

Durham University Business School

Durham University, UK

E-mail: mehmet.asutay@durham.ac.uk

Presented at

Istanbul Islamic Finance Summer School 2014

Jointly organised by Sabahattin Zaim University & Durham University

Istanbul

17 June - 20 June 2014



Introduction (1)

- Teaching and research into economics, finance and management has been dominated by the hegemony of rational and self-interest maximizing individual as the foundation of economic analysis since the marginalist revolution with neo-classical economics in early 20th century;
- Neo-classical model is substantiated with the partial analysis of economic reality by divorcing it from the larger socio-political-economic spheres and value systems;
- The return of moral/ethics in the face of unsustainable production and consumption patterns in particular since late 1960s; see the references made to the ethical deficiency of capitalism in the face of financial crisis;
- Hence, recognition and acknowledgement of values as an important variable/factor explaining through different mechanism of economic and financial behaviour, but also aiming to construct alternative economic systems.

Introduction (2)

- As part of this recognition, we have witnessed the emergence of Islamic moral economy and Islamic finance since late 1940s;
- **Islamic finance industry has progressed from humble beginnings**
 - Concept has been rediscovered to build a USD 2 trillion industry
 - Global momentum behind industry: consumer, corporate and government
 - Islamic finance has become the proposition of choice in the GCC, and likely to become proposition of choice throughout the Muslim world;
- **Islamic finance in its original form is located within the foundational claims** of Islamic Moral Economy, as the aim was to creating an Islamic moral economy with Islamic finance being the operational aspect of that system.
- However, Islamic finance seems to be expanding neo-classical norms and forms; resulting into a new debate: **Islam based financing vs. the Shariah compliant financialisation**;

Introduction (3)

- This session aims to provide an overview of the original claim and discourse of Islamic finance rooted in the articulation of Islamic moral economy foundations and principles;
- In doing so, an attempt will be made to rationalise the plurality of economics and finance systems and also 'religion and economics/finance' is discussed;
- In demonstrating the plurality of economics and finances, historical developments and also the observed convergence is discussed;
- To provide further rationale, moral economy is discussed;
- Within moral economy, pluralism and historical contexts, Islamic moral economy is presented;
- Islamic finance is located within Islamic moral economy by defining and expressing the moral foundations;
- The divergence between Islamic moral economy aspirations and realities of Islamic finance is also touched upon.

The Story



Wall Street Protests

- **Chronic and systemic failures in the banking and financial system;**
- **Leading to macroeconomics imbalances;**
- **Search for alternative systems/ institutions/practices**

Civilisation and Economics/Economy (1)

- Civilisations are articulated through their worldviews which includes values, norms, axioms and foundational principles; and aims at construction of a social form with a particular definition of human within that worldview.
- Each civilisation is also articulated through various systems organising the operation of life but also knowledge in the society.
- The term system refers to “functional components that together make certain sectors of the ethico-economic order work”, which therefore refers to an integrated whole as part of an order.
- Islam, in this, represents an another civilisation and order, and within this order Islamic economics and other systems related to everyday day life is possible.
- “An ‘order’ is thus a totality of several systems integrated together through the bond of ethical relationships”. Various systems (economic, political and social), therefore, in the Islamic order are linked through the ethical propositions of Islam.

Civilisation and Economics/Economy (2)

- Each tradition or civilisation has a particular social formation;
- Social formation refers to the reality of the social context within which the modes of production operates, and therefore social formation refers to the actual history of a society;
- While social context refers to the society in its entirety such as the social and political pattern develops from a particular mode of production, a mode of production, as result, itself, is the theoretical construct of that particular social context and hence social formation;
- Mode of production is comprised of two elements: 'forces of production' and 'relations of production'. Thus, it constitutes 'the base';
- It is expected that a particular mode of production should lead to a particular type of 'superstructure', which implies political, social and economic structure of a society within which the mode of production operates.
- Thus, modes of production and the 'superstructure' enables us to identify a particular 'social formation'.

Civilisation and Economics/Economy (3)

- Historically, each civilisation has had their social formation in relation of their own social context which is determined by and determined the mode of production of the society;
- Confucian civilisation organised the social formation of the society different than Islamic civilisation, which also had different modes of production in relation to Christian-Judeo civilisation;
- As each civilisation defined the 'forces of production' and the 'relation of production' in a particular manner by responding to the following question in a particular way:
 - 'What is labour?';
 - 'What is capital?';
 - 'What is labour division?';
 - 'Who is labourer?';
 - 'Who is capitalist?';
 - 'What is the relationship between labour and capital in the labour division?';
 - 'Who owns what and why and how long?'
- These are the important questions determining the distinguishing nature of each civilisation; and through such lines that civilisation developed or collapsed.
-

And Whither the Civilisations: Convergence (1)

- The rise of modernity as a project introduced a break in the history, as Fukayama states the end of history is determined by modern modes of production and hence social formation in the form of capitalism;
- Thus, historically before the current convergence, the civilisations lost their social formation to ideological positioning which became the new force to determine the modes of production and social formation of societies;
- Consequently, 20th century witnessed the rise of two main modes of production and social formation: capitalism and communism in various shapes in addition to underdeveloped 'third world', which struggled between the two;
- The last quarter of the 20th century demonstrated that capitalism as part of Western civilisation in terms of modes of production and social formation has overcome the other ideological worldviews but also in essence other civilisations as well.
- From plurality of modes of production and social formation, Macdonaldisation of societies has taken place;
- Thus, each and every modes of production/social formation converged towards capitalist form and Western social formation; as the distinctions became invisible in the process for search for economic and financial 'efficiency'.



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 9

And Whither the Civilisations: Convergence (2)

- The rise of modernity as a project introduced a break in the history, as Fukayama states the end of history is determined by modern modes of production and hence social formation in the form of capitalism;
- Thus, historically before the current convergence, the civilisations lost their social formation to ideological positioning which became the new force to determine the modes of production and social formation of societies;
- Consequently, 20th century witnessed the rise of two main modes of production and social formation: capitalism and communism in various shapes in addition to underdeveloped 'third world', which struggled between the two;
- By the last quarter of the 20th Century, each and every modes of production/social formation converged towards capitalist form and Western social formation; as the distinctions became invisible in the process for search for economic and financial 'efficiency';
- From plurality of modes of production and social formation to poverty of systems.



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 10

The Break in the Convergence: Coming Back of Ethics/Moral and Religion into Economics and Finance and Policy Making

- Due to a number of issues; not only the second best solution of neo-classical economics, but any other solution has proved to be not working efficiently due to:
 - Developmentalist failures;
 - Poverty;
 - Sustainability;
 - Environmental crisis;
 - Financial and economics crisis (not being sporadic but systemic);
 - Missing of individuals in the analysis;
- *Responses*: search for ethically acceptable production and consumption norms and notions;
- *Theoretical responses*: the rise of modern political economy/economics; institutional economics; theoretical conviction that institutions, values, cultures, norms and religions can be an important variable in explaining development or underdevelopment.



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 11

The Rationale for Different Economic Approaches/Systems

- It is a fact that no human endeavour is value-free, which implies that reality including economic reality is socially constructed.

- J. S. Mill (1836): **assumed premises.**

“Political economy, therefore, reasons from assumed premises which might be totally without foundation in fact, and which are not pretended to be universally in accordance with it”.

- J. S. Mill (1836): **light** by which they think they see it (emphasis added)

“Now in whatever science there are systematic differences of opinion ... the cause will be found to be, a difference in their conceptions of the philosophic method of the science, the parties who differ are guided, knowingly or unconsciously, by different views concerning the nature of the evidence appropriate to the subject. They differ not solely in what they believe themselves to see, but in the quarter whence they obtained the light by which they think they see it” (emphasis added)



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 12

The Rationale for Different Economic Approaches/Systems

- Schumpeter (1954): **Vision.**

“Analytic effort is of necessity preceded by a pre-analytic cognitive act ... called Vision.”

- Thus: economics and finance are value-loaded, as at the most abstract level, our values are derived from our worldview.
- Since values are determined by religion, tradition, and culture which is the articulated forms of civilisations.

Articulation of Religion in Neo-Classical Economics/ Finance Theory and Practice (1)

- Max Weber (1905) was the first to identify the significant role that religion plays in social change. He went as far as to state that the Protestant Reformation triggered a mental revolution that made possible the advent of modern capitalism;
- Thus, Weber (1930) argued that religious practices and beliefs had important consequences for economic development. Nevertheless, economists and other researchers have paid little attention to religion and other measures of culture as determinants of economic growth;
- Almost a century after Weber’s seminal work, the importance of religion despite and within neo-classical economics has surfaced;
- Previous research in their attempt to assess the determinants of economic growth has isolated a number of variables that predict subsequent rates of economic growth.

Articulation of Religion in Neo-Classical Economics/ Finance Theory and Practice (2)

- However, successful explanations of economic performance have to go beyond narrow measures of economic variables to encompass political and social forces;
- In particular, the empirical results reveal important influences on growth from government policies and public institutions;
- Some researchers (see: Huntington, 1996; Landes, 1999; and Inglehart and Baker, 2000; recently Acemoglu, 2012), argue that explanations for economic growth should go further to include a nation's culture and political structure;
- Culture is usually thought to influence economic outcomes by affecting personal traits such as honesty, thrift, willingness to work hard, and openness to strangers;
- Religion is one important dimension considered affecting economic and financial systems and performances but also management styles.

Articulation of Religion in Neo-Classical Economics/ Finance Theory and Practice (3)

- **Religion and economic development:**

“The number of micro-level social anthropological studies is continually growing. Many of these concentrate on what to the economist may appear odd aspects of society such as ritual and religion ... and to which he pays little or no attention. For instance, an understanding of the complex of Hindu religious beliefs as they operate at village level ... is directly relevant to the problem of developing India's economy. This is but one of numerous examples which can be quoted to support the claim that development economists work in the dark unless they acquaint themselves with the relevant socio-political literature”. - T. Scarlett Epstein (1973, p.6)

- Within neo-classical economics, hence, in recent years, religion is considered as an endogenous factor which may facilitate economic development through being a **social capital** and also due to establishing trust and hence reducing **transaction cost**.

Articulation of Religion in Neo-Classical Economics/ Finance Theory and Practice (4)

The Economic View of Religion (1)

- Studies in the economics of religion within neo-classical economics can be categorised into three groups: first, those links between religion and economic theory;
 - Policy studies such as debates about faith-based welfare programmes, and the economic regulation of the church;
 - empirical studies on the influence of religion on economic behaviour
- Adam Smith - *the Wealth of Nations* - is considered a precursor of this strand of approach

Articulation of Religion in Neo-Classical Economics/ Finance Theory and Practice (5)

The Economic View of Religion (2)

- Broadly socio-economic view of religion - rational choice approach (Azzi and Ehrenberg, 1975; Iannaccone, 1998; Stark, Iannaccone and Finke, 1996; and Stark and Finke, 2000). Focus: both on the supply side: the structures of religious organisations, and on the demand side: the preferences of consumers in religious economies;
- The micro-view: religious activity as the outcome of rational choice, with utility derived both in the individual's lifetime and in the afterlife;
- The impact of game theory on theological beliefs (Brams, 1983);
- Sociological theories by the theoretical economic analysis of intergenerational transmission of ethnic and religious traits through family socialization and marital segregation decisions (Bisin and Verdier, 2000). The focus here is on endogenous preference formation and the manner in which the family and the society influence cultural traits (Bisin and Topa, 2003).

Introduction to Moral Economy

- **Interdisciplinary Perspectives on Moral Economy**
 - Philosophy: some analytical distinctions
 - Political philosophy and political economy: what is the relationship between market economies and moral economies
- **Senses of 'Moral Economy'**
 - An approach to the study of an object:
 - A discipline defined by an object of study
 - A particular kind of economy

Senses of Moral Economy (I): An Approach to the Study of an Object:

(i) Moral economy is the application of ethical categories to the study of the economy.

- The elimination of ethical concepts in neo-classical economics leads to the 'descriptive impoverishment' of economics. (Sen, 1978 p.185; 1980 p.362).
- 'When economists spoke "qua economist" ...they tried to speak in a value-free "scientific" language with "expletives" deleted.' (Sen 1980 pp. 363-4).
- 'The fact-value dichotomypenetrated neo-classical economics after 1932... [with] the resultant impoverishment of welfare economics' ability to *evaluate* what it was supposed to evaluate—*economic wellbeing*. (Putnam, 2002, p.62)
- Economics needs to rediscover the ethically 'rich descriptions' that marked the work of Adam Smith, the early Marx etc. (Sen, Putnam, Walsh, Nussbaum)

(ii) Moral economy is the application of economic categories to the study of ethics - the use of rational choice models, game theory etc. to explain the development of moral norms.

Senses of Moral Economy (2): A Discipline Defined by an Object of Study

- Moral economy is the study of the ethical character of economic life.
 - Moral economy is 'the critical study of the ethical character of economic activities and relationships, and of how this shapes and is shaped by other dimensions of social and political life'.

Senses of Moral Economy (3): A Particular Object

- Moral economy comprises a particular set of relationships, beliefs and norms that constitute a particular kind of economic life.

Consequently,

As can be seen, all these three dimensions of moral economy fits into articulated nature of Islamic economic order; and therefore by definition Islamic proposition is a moral economy in every sphere of economic, financial, social and political dimensions of everyday life.

Market Economy as a Moral Economy?

- A particular kind of economy
- A moral economy is an economy that is embedded in or oriented by moral norms.
- Claim by both critics and defenders of market economies: markets are not moral economies in this sense. Markets are 'ethics free zones'.
- Contrast of market and household (Aristotle, Polanyi, Marx)
- Contrast with 'domestic moral economy'?
- Market economies disrupt the moral economies of pre-capitalist societies.
- The choice of agents are made in response to the relative prices of goods
- Choices are constrained and regulated by the movements in the exchange values of different goods.
- The exchange value of objects becomes a common unit through which decisions are made.
- The shifts in exchange values are the unintended consequence of the collective outcomes of individual actions of agents.
- Hence, they are independent of any social or ethical ends that might be held either individually or in common, e.g. there is no 'just price'
- Market economies are in this special sense 'disembedded economies': decisions are not constrained directly by social custom and ethical goals, but rather respond to a system that proceeds independently of these.

Moral Economy Features

- Polanyi (1944):
- The embedded economy nature existed since primitive-archaic time.
- However, the creation of self-regulated market, dis-embedded resulting into the creation of fictitious commodities through commoditisation;
- As a result, the constitution of the idea of market economy caused the malaise of society by changing the social formation of societies.
- The traditional forms of economy have always been moral economy through its traditional social formation;

Moral Economy Features (2)

- Therefore, the struggle of re-embedding economy in society and rescuing labour, land and money from the 'fictions commodity' or to de-commodificate them has been the aim of protective social movements and anti-liberal discourses.
- Islamic moral economy, hence, is another part of such double movement/ counter movement to re-embedding the economy to ensure the dignity of labour and fair distribution of resources.
- Polanyian discourse is essential for us to understand the emergence of Islamic moral/political economy/Islamic economics through embeddedness through essentialising profit-loss-sharing financial products; risk sharing; and asset based financial transactions.



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 25

Contextualising Moral Economy

- **Constitutive incommensurability**

From a person in the Narmada Valley in western India on being displaced as a result of the Sardar Sarovar Dam, to the Chief Minister of the state government.

'You tell us to take compensation. What is the state compensating us for? For our land, for our fields, for the trees along our fields. But we don't live only by this. Are you going to compensate us for our forest?...Or are you going to compensate us for our great river - for her fish, her water, for vegetables that grow along her banks, for the joy of living beside her? What is the price of this? ...How are you compensating us for fields either - we didn't buy this land; our forefathers cleared it and settled here. What price this land? Our gods, the support of those who are our kin - what price do you have for these? Our adivasi (tribal) life - what price do you put on it?' (Brava Mahalia (1994) 'Letter from a Tribal Village' Lokayan Bulletin 11.2/3, Sept-Dec.)



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 26

Moral Economy: In Concluding

- The notion of the moral economy rests with a central principle: embeddedness.
- Premodern economies are moral because they are an integral part of social relations and noneconomic institutions.
- Of course, how economic and social relations work together will differ depending on various contexts but the common thread running through an understanding of a premodern moral economy is that aims, objectives and processes are informed and directed by the noneconomic (Polanyi, 1957; 1960; 1968; Scott, 1976).
- Moral Economy's features are:
 - Reciprocity
 - Community and distribution and charity
 - Convention and coordination
 - Collective action: cooperation including labor sharing
 - Embeddedness or non-economic factor.



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 27

The Break in the Convergence: Imagination of Islamic Economic Order for a Moral Economy (1)

- The rise of independent Muslim states in the post-colonial and post WW II period, and search for an authentic Muslim identity through a constructivist approach resulted in socially constructing an Islamic model of economics and economy;
- In the opinion of the founding fathers, the failure of economic development was attributed to capitalist economic development strategies, which ignored the importance of human being and its well-being.
- Their objective was therefore **to develop an economic system understanding**, which could develop a human-centric development strategy, which is considered to be 'ideal of Islamic developmentalism' in economy'
- The Islamic moral economy paradigm aimed at the creation of the Islamic paradigm of economics with its distinct values, norm, rules and institutions with a politically oriented systemic understanding with intra and intergenerational equity;
- Islamic moral economy also aims to shape the behavioural norms of individuals to operationalise the system.



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 28

The Break in the Convergence: Imagination of Islamic Moral Economy- Definition (2)

- Islamic economics "aims at the study of human (happiness) and participation" (Akram Khan, 1984: 55).
- "Islamic Economics has a different task with conventional economics. Duties in addition to studying the reality of the behavior of economic agents, both domestic producers, domestic consumers, and governments, also must formulate the concept of ideal behavior according to Islamic teachings should be made by economic agents, as well as its effects are possible for the economy" (Chapra, 2000: 127-128).
- The individual objective function is summed by *falah* through the *ihsan* or beneficence process.

The Break in the Convergence: Imagination of Islamic Moral Economy (3)

Islamic economics/moral economy is described as:

- part of religion, Islam;
- deals with production, consumption and distribution activities of human beings according to Islamic worldview;
- making economic and financial choices according to Islam;
- describes, analyses, prescribes;

Islamic moral economy, thus, is an "approach to, and process of, interpreting and solving the economic problems of human beings based on the values, norms, laws and institutions found in, and derived from the sources of Islam".

Islamic finance is the institutional aspect of Islamic economics, as to finance the economic activity in an Islamic framework, there is a need to have institutions using instruments according to rules and regulations, which are all bound by the Shari'ah.

Islamic Moral Economy As a System (1)

For constructing Islamic moral economy/political economy as a system the followings, hence, are necessary:

- (i) The organisation of decision-making arrangements;
- (ii) Mechanisms for the provision of information and co-ordination
- (iii) Property rights;
- (iv) Incentive mechanism

Islamic Moral Economy As a System (2)

In order to talk about 'systems' in the economic realm the following is necessary:

- (i) Framework paradigm (with ontological and epistemological sources) in terms of point of reference;
- (ii) Value system;
- (iii) Foundational axioms;
- (iv) Operational principles/mechanism;
- (v) Specific Methodology;
- (vi) Functional institutions.

When analysing whether Islamic Political Economy proposes an alternative system, these characteristics have to be located among the components of the Islamic economic paradigm.

Islamic Moral Economy: A Value Oriented Proposition

- Islamic moral economy, in modern sense, developed since 1970s aiming at development issues; and therefore in the essence of this constructivist world view there was a response to the failures of capitalist and socialist economic development projects in the Muslim world;
- The founding fathers aimed at creating an Islamic response to this failures by constructing a human-centred development model based on the ontology and epistemology of Islam;
- **Islamic financing** expected to provide an alternative solution as a financing tool and method;
- Ethicality in this value proposition in the original sense is not only prohibition of *riba* (interest) but relating to larger social and economic development issues;
- A financing proposition shaped by the rules (fiqh) but also moral values of Islam;
- ‘Form’ but also ‘substance’ is expected to be Islamic as well;



Islamic Moral Economy: A Value Oriented Proposition - Foundational Axioms (I)

Islamic moral economy aims at creating a moral based economy, with the following axioms:

- Vertical ethicality - the Oneness of God (*tawhid*), God’s prophets as the source of Divine Guidance (*risalah*), (life-after death, that is the continuity of life beyond death and a system of accountability based on Divine Law (*akhirah*); and hence vertical equality; The vertical ethicality or the equality of individuals in their relations to the creator, God, and having equal opportunities for the bounties on earth created by God; namely *tawhid*;
- Horizontal ethicality/equality - Social justice and beneficence (*adalah* and *ihsan*), which constitutes the horizontal equality between individuals within the *tawhidi* framework



Islamic Moral Economy: A Value Oriented Proposition - Foundational Axioms (2)

- Growth in harmony (*tazkiyah*); As a direct result of the vertical and horizontal ethical axioms, Islamic Moral Economy assumes growth in individual, social, economic and biological environment to take place in harmony with the stakeholders within the spiritual framework of *tazkiyah*
- *Rububiyah* (perfecting things towards perfection) -Islamic Moral Economy, as consequence of the above axioms, assumes in a functional sense enabled individual, society and natural environment so that each of these can reach its perfection within tawhidi framework, as God has chosen perfection as a path by definition for everyone and everything. This refers to *rububiyah* as the functional axiom;

Islamic Moral Economy: A Value Oriented Proposition - Foundational Axioms (3)

- *Fard*: In fulfilling *rububiyah* in all aspects of individual, society, economy and environment *tazkiyah* process aims to overcome the conflict between individuals and society. Therefore, IME assumes that in order to overcome the perceived conflict between individual and society, voluntary action is not perceived to be enough; and hence certain socially oriented financial and economic obligations are made mandatory, or *fard*, so that moral economy objectives should be achieved

Islamic Moral Economy: A Value Oriented Proposition - Foundational Axioms (4)

- **Haqq (Right)**

Individuals are created with their dignity and right to exist and be part of any kind of transaction or contract as an extension of hurriyah or freedom.

However, rights are linked to responsibilities; and therefore when rights can only be charged and meaningful only in relation to responsibilities.

Islamic teaching identifies through maqasid al-Shari'ah that no one's rights can be obscured or infringed; equality in front of worldly law and in front of God through spiritual accountability and amanah actualises this process.

Haqq has implications for the use of resources through amanah, tazkiyah and rububiyah, which constitute an essential foundation of Islamic moral economy.



Islamic Moral Economy: A Value Oriented Proposition - Foundational Axioms (5)

- **Amanah (Trust)**

The Tawhid axiom asserts the position of human being as God's vicegerence. In such understanding, God had rendered his trust to them to well administrate this world to be a peaceful and safe place for them to live.

God also designed special task for the vicegerents to be executed: to exalt him ('ibaadah) and to develop this world ('imarah). As 'trustee', every single individual are being rendered with trust (amanah) in his or her horizontal relations with other individuals. Everything in the universe belongs to God and everything was created for the service of man, who may use anything in the world for a positive purpose, but he is not supposed to abuse anything. The 'entrusts' are the rights and responsibilities of one individual over the other (al-Qur'an, 7:74).



Islamic Moral Economy: A Value Oriented Proposition - Foundational Axioms (6)

- **Islah (Reform)**

Due to its original meaning of piety and good, *islah* represents the permanent behaviour of transforming towards the direction of betterment and perfection. Similarly, *islah* also means the transformation from the state of bad to good, from good to better and from better to perfection. Therefore, its usage for 'mutual reconciliation' or *musalaha* involves mutually agreed consideration towards enhancement and to bring an end to *fasad* (destruction or mischief) (Ibn al-Manzur, 1955: 2/ 516-17).

Islah could supposedly defined as "a state of constant endeavour towards comprehensive excellence (*ihsan*) within the frameworks of innovative, constructive and reconstructive to attain *falah* according to *Maqasid al-Shari'ah*". This definition was explicitly illustrated in al-Qur'an (3: 104): "And there may spring from you a nation who invite to goodness (*khayr*), and enjoin right conduct (*ma'ruf*) and forbid indecency (*munkar*). Such are they who are successful".



Islamic Moral Economy: A Value Oriented Proposition - Foundational Axioms (7)

- **Khilafah and human accountability before God (Individual's role as God's vicegerent on earth)**

In operationalizing such expectations as expressed within the axioms of Islamic Moral Economy, as part of *tawhidi* framework, individual is perceived to be vicegerent of God on earth, namely *khalifah*, to fulfill the expected duties in their social, economic, financial and other behaviours to make their decision through a moral filter.

In other words, since the individuals are considered to be the representative of God on earth, they are expected to fulfill such roles and responsibilities.



Islamic Moral Economy: A Value Oriented Proposition - Foundational Axioms (8)

- **Ukhuwwah (Solidarity)**

Islam portrays that the relationship of each individual as that of a family member which embraces all Islamic communities wherever they are (Buckley, 2000: 5). As Iqbal and Mirakhor (2007: 9) stated, the idea of collectivism generates the concept of unity for mankind and leads to the principles of equality.

Individuals should be treated equally and should not be discriminated against to its wealth, race, gender, caste, skin colour and etc., which would lead to disunity. Solidarity in Islam carries a wider concept, which suggests collective cooperation and guaranteeing the safety of each other's well-being.

Hence, this concept is deduced from the role of khalifah, which specifies the purpose and responsibilities of an individual's creation as His vicegerent on earth. The mission of populating and exploiting the earth are being forced to give way to khalifah as a gift, trust and also a test (Yousri, 2005: 33).

Islamic Moral Economy: A Value Oriented Proposition - Foundational Axioms (9)

- **Maqasid al-Shari'ah**

All these axioms, as the foundational framework of IME, are the articulation and operationalisational aspect of *maqasid al-Shari'ah* or the 'objectives of *Shari'ah*' process, which is defined as realizing 'human well-being'. In other words, the entire objective of IME and also its operational aspect of *Shari'ah* is to serve 'human well-being' which is the main and essentialised aim of all efforts within the *tawhidi* framework.

Implications of the Foundational Assumptions of Islamic Moral Economy (1)

- Human beings can only claim partial credit for what he/she produces... The needy and society have a right too; *zakah*, etc.;
- Responsible use of rightful earnings by keeping the moral purposes of human beings in view;
- Individuals must not prevent others in society and nature from meeting their basic biological needs;
- All people should have equal opportunities to benefit from environmental and public resources.
- Wealth creation and effort is necessary and good. However, the immoral, prohibited modes (*riba* prohibition as well as some economic activity harmful to individuals), oppressive exploitation of human beings and creation of ecological imbalance or environmental disruption.

Implications of the Foundational Assumptions of Islamic Moral Economy (2)

- Islamic moral economy aims to achieve *falah* (salvation) by essentialising and maximising *ihsan* (benevolence), as a social capital, through the notion of the individual's role as the vicegerent (of Allah) role on this earth.
- The success of an individual depends among many other things, on the acquisition, allocation and disposition of the resources, which are *amanah* or trust, according to the consent of Allah. Hence, the nature of Islamic moral economy.

Implications of the Foundational Assumptions of Islamic Moral Economy (3)

- The Islamic Moral Economy's further implications and its articulation:
- Human beings are urged to use the resources in this world to achieve success not only in this world, but in the life hereafter as well. In the mould of Aristotelian ethics, one of the most prominent scholars in Islamic scholarship, Al-Ghazali, mentions four means to achieve this ultimate success:
 - (i) goods of the soul,
 - (ii) goods of the body,
 - (iii) external goods and
 - (iv) divine grace.
- Material pursuits (wealth) would be considered external goods that are part of the provisions to achieve success provided it does not contradict the other categories, especially the goods of the soul (faith and good character or knowledge and right action).
- The ethical imperatives of this requirement are again very profound. Justice is the observing of moderation in all things. All virtuous qualities of the soul are thought to stem from temperance and justice while selfishness/greed is not seen as a virtue

Implications of the Foundational Assumptions of Islamic Moral Economy (4)

- Ethical order develops through the following path:

Islam ==> Iman ==> Ihsan
↓ ↓ ↓

- Knowing ==> Doing ==> Becoming
- Thus, Islamic moral economy is a becoming process through achieving ihsan.

Implications of the Foundational Assumptions of Islamic Moral Economy (5)

In sum, the main objective of Islamic Economics is to establish

- social justice,
- elimination of poverty,
- tangible reduction in economic disparities,
- free of corruption society
- institutionalisation of zakah,
- interest free system,
- moral and ethical instruments of Islamic teachings;
- Hence, an embedded society (with norms and moral of Islam) with real commodities (as opposed to commodification)
- With the ultimate goal of seeking divine grace (swt).

The Operational and Institutional Features of Islamic Moral Economy

- Social change is essential and has to take place for the progress of the societies;
- Self-interest is a natural motivating force in all human life, which must be linked to the overall concept of good and justice;
- Private property and private enterprise are essential but property in its all forms is a trust (*amanah*), and as such, property rights are subject to moral limits and used as a means of fulfilling ethical objectives - the *Maqaasid al-Shari'ah* (the objective of the Islamic way).
- Cooperation and competition defines the framework for economic activity.
- The market mechanism is a fundamental pillar of the Islamic moral economy, but the consequences of market system has to be moderated;
- The prohibition of certain sources of income is a particularly distinctive plank of the Islamic economic system.

The Methodology of Islamic Moral Economy

The methodological postulates of Islamic moral economy, on the other hand, can be summarised as follows:

- Sociotropic individual, not only individualism but social concern is a prerequisite;
- Behavioural postulates: socially concerned God-conscious individuals who (a) in seeking their interests concern with the social good, (b) conducting economic activity in a rational way in accordance with the Islamic constraints regarding social environment and hereafter; and (c) in trying to maximise his/her utility seek to maximise social welfare as well by taking into account the hereafter as well.
- Market exchange is the main feature of economic operation of the Islamic system; however, this system is filtered through an Islamic process to produce a socially concerned environmentally friendly system. In this process, socialist and welfare state oriented frameworks are avoided not to curb incentives in the economy.

Consequently, two-dimensional utility function (present and the hereafter), which leads to homolamicus, or

'*Tab'ay*' (obedient) human-being. "To be a Muslim is a necessary but not a sufficient condition to be a *Tab'ay*". As to be qualified as a *tab'ay*, one needs to operationalise Islamic principles in every aspects of her/his life.

Mechanisms/Institutions/ and Instruments of the Islamic Moral Economy System

Islamic moral economy and financial activities are shaped by there kinds of measures:

- Positive measures (*zakah; hisbah*)
- Voluntary measures (*sadaqah, waqf*)
- Prohibitive (*riba'*)

Islamic Economic and Financial Institutions and Instruments

- (i) Elimination of riba;
- (ii) Islamic financial system;
- (iii) Trade and commerce facilitation;
- (iv) Islamic commercial law and application;
- (v) Takaful;
- (vi) Hisbah;
- (vii) Zakah and Zakah fund for development;
- (viii) Awqaf system;
- (ix) Social welfare institutions and charities;
- (x) Developmentalist institutions;



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 51

Summarising the Aspirations of Islamic Moral Economy

Ibn Khaldun's (15th century)'s framework provides a summary of the interdisciplinary dynamic model for Islamic socio-economic system:

- “The strength of the sovereign (*al-mulk*) does not become consumed except by implementation of the *Shari'ah*;
- The *Shari'ah* cannot be implemented except by a sovereign (*al-mulk*);
- The sovereign cannot gain strength except through the people (*al-rijal*);
- The people cannot be sustained except by wealth (*al-mal*);
- Wealth cannot be acquired except through development (*al- 'imarah*);
- Development cannot be attained except through justice (*al- 'adl*);
- Justice is the criterion (*al-mizan*) by which God will evaluate mankind; and
- The sovereign is charged with the responsibility of actualising justice”.



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 52

Consequently...

- Islamic economic and financial system, on the one hand, aims to guarantee individual liberty, freedom of choice, private property and enterprise, the profit motive and possibilities of unlimited effort and reward.
- On the other hand, it seeks to provide effective moral filters at different levels of life and activity and established institutions in the voluntary sector, as well as through state apparatus to ensure economic development and social justice in the society.
- Islam does not prescribe a particular economic system but provides the core elements and principals, which form the basic philosophy of a system or an economy.
- Islam provides primarily normative principles for economics and finance. However, it is not devoid of positive economic statements or hypotheses. Several areas of economics are truly positive and cannot be different in an Islamic or in any other framework.

Islamic Moral Economy and Finance: A Value Oriented Proposition

- As the foundational axioms demonstrate, as a system, Islamic moral economy refers to economic and sustainable development, social justice and social investing oriented principles;
- They aim to respond to economic development failures by offering a dynamic and micro solution to the problem;
- The aim is to develop functioning individuals in terms of doings and beings through creating the right and just environment and opportunity spaces for such development to take place;
- Islamic financing in this paradigm thus was imposed the role of generating the necessary funding for economic development by abiding the norms of the social and moral economy.

Islamic Finance Principles Reinforce the Ethos of Islamic Moral Economy

- Islamic moral economy has an explicit value framework

- Based on justice, equity, human dignity, freedom of enterprise and moderation



- Based on developing and harnessing economic resources to satisfy spiritual, material and social needs of all members of the community
- Based on a moral obligation to serve poor and destitute from share of wealth

Islamic finance is based on socially responsible investing

Moral Economy Definition of Islamic Finance Principles: Ethos of Islamic Moral Economy in Practice

(i) *Prohibition of interest or riba*, which is explicitly revealed in the Qur'an: reference to the social but also economic consequentialist reasons and rationale for this prohibition; prohibition of interest provides a stable and socially efficient economic environment.

(ii) An important consequence of the prohibition of interest is the *prohibition of fixed return* as provided by interest: capital should be able to gain whatever return is due for its share through an economic activity in the real economy rather than in the financial economy.

Thus, by prohibiting interest, IME aims at productive economic activity or *asset-based financing* over debt-based system; the latter being the main feature of conventional banking and finance. Thus, the asset-backing principle requires that all financial activities must be referred to as tangible assets.

Moral Economy Definition of Islamic Finance Principles: Ethos of Islamic Moral Economy in Practice

(iii) The IME position related to money provides another rationale for the prohibition of interest, which states that money does not have any inherent value in itself; and therefore money cannot be created through the credit system.

(iv) By prohibiting interest, IME does not undermine the position of capital, but rather changes the nature of the relationship between capital and work.

The principle of **profit and loss sharing** (PLS) is the essential axis around which economic and business activity takes places. This prevents capital owner from shifting the entire risk onto the borrower, and hence it aims at establishing justice between work effort and return, and between work effort and capital.

This implies that **risk sharing** is another important feature of IBF.



Moral Economy Definition of Islamic Finance Principles: Ethos of Islamic Moral Economy in Practice

(v) An important feature as the consequence of profit-and-loss sharing principle is the participatory nature of economic and business activity through participatory financing. Through profit-and-loss sharing, Islamic financial instruments, capital and labour merges to establish partnerships through their individual contributions.


The shuratic (consultative) method of governing business is, thus, a natural outcome of this process, which is expected to lead to good governance processes in political sphere as well.

(vi) By essentialising productive economic and business activity, in addition to prohibiting interest, uncertainty (gharar), speculation and gambling is also prohibited with the same rationale of emphasising asset-based productive economic activity. However, new legal (fiqhi) scholarship is in favour of acceptable levels of uncertainty to facilitate modern financial instruments.



Islamic Finance is More than Financial Contracts

Tenet-bound	Principles-based
<ul style="list-style-type: none"> • Fundamental tenants are derived from Shariah <ul style="list-style-type: none"> - Absence of interest-based transactions - Avoidance of economic activity involving speculation - Prohibition on production of goods and services which contradict the values of Islam 	<ul style="list-style-type: none"> • Concept is grounded in ethics and values <ul style="list-style-type: none"> - Principles akin to ethical investing - Emphasis on risk-sharing and partnership contracts
Embedded Financing- Real economy-linked	Social and Development Objectives
<ul style="list-style-type: none"> • Islamic finance offers an alternative paradigm <ul style="list-style-type: none"> - Asset-backed transactions with investments in real, durable assets - Stability from linking financial services to the productive, real economy - Credit and debt products are not encouraged - Restrains consumer indebtedness 	<ul style="list-style-type: none"> • Islamic banking is community banking <ul style="list-style-type: none"> - Serving communities, not markets - Aims to enable and function individuals - Open to all-faith clients - Instruments of poverty-reduction are inherent part of Islamic finance (zakaat & qard hasan)
<p>A holistic approach to financing a society; in essence a value and moral proposition and more than financial contracts</p>	



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 59

Islamic finance aims and positive impact

- 1

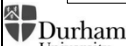
- **Engagement of an under-served and previously un-banked market**
 - Providing an ethical banking solution to local communities to deepen the banking market
- 2

- **Promoting the investment mindset rather than the banking mindset**
 - Investing in real assets rather than promoting speculation and leverage
- 3

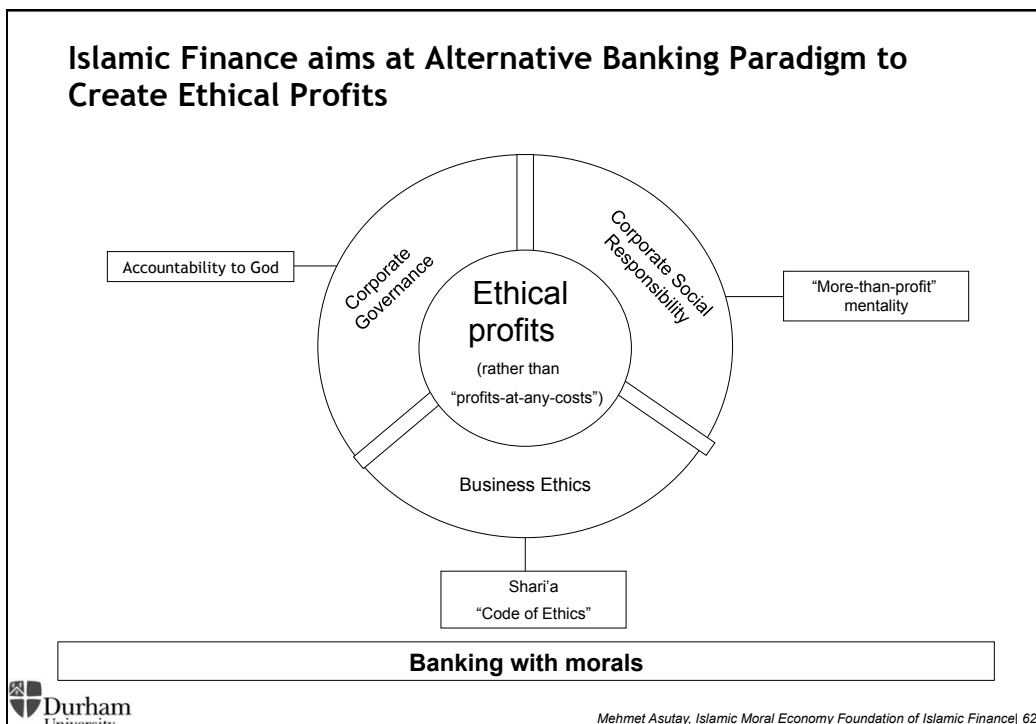
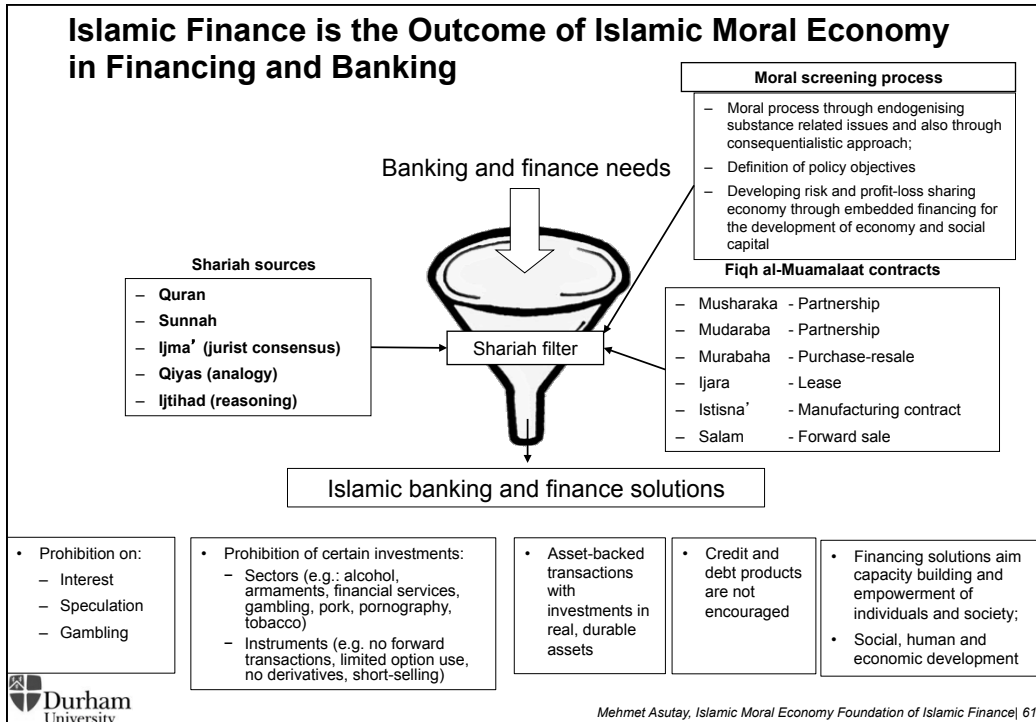
- **Making meaningful real economy impact**
 - Investing in asset-backed instruments and real economy ventures
- 4

- **Attracting foreign investment and cross-border partnerships from Islamic financial institutions**
 - Attractive source of cross-market ventures and cross-border lines from Islamic countries

A growing industry promising benefits



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 60



Conceptually, Islamic Banking is Rooted in Developmental Aims of Islamic Moral Economy

- **IBF can fulfill the moral economy objectives by following strategies:**
 - Direct investments: Banks independently employ funds in profitable projects
 - Participation investments: Banks as capital partner with share in projects in PLS arrangement
 - Equity-based structures: Private equity, venture capital, project and trade finance
 - Ethical underpinning: Investments inherently follow International Equator Principles*
 - Financing the 'unbankable' individuals to create social capital for development through microfinancing; and other financial instruments, such as zakah funds, qard al-hassan;
 - Contributing economic, social and human development by returning the right of society to society and by engaging with projects to increase the social return.

*Financial industry benchmark initiative, introduced in August 2006, for determining, assessing and managing social and environmental risk in project finance



Historically driving connectivity with the real economy

Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 63

Islamic Finance, in an aspirational sense of authentic meaning, aims at...

Islamic banking and finance aims at:

- Community banking: Serving communities, not markets;
- Responsible Finance, as it builds systematic checks on financial providers; and restrains consumer indebtedness; ethical investment, and CSR Initiatives;
- Alternative Paradigm in terms of stability from linking financial services to the productive, real economy; and also it provides moral compass for capitalism;
- Fulfils Aspirations in the sense it widens ownership base of society, and offers 'success with authenticity'.



Historically driving connectivity with the real economy

Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 64

Islamic Finance and Socio-Economic Development

- Since economic development is a larger concept, Islamic Finance with its current structure has not been able to affect nor has it aimed at affecting the economic development in a systematic manner;
- This does not mean that Islamic finance does not have impact on economic growth; on the contrary due to financial development and pooling of funds it does contribute economic growth. However, economic development is beyond the growth of the economy.
- ‘Islam’ in IBF refers to particular value system beyond conventional banking understanding; and that is the banking aiming to fulfill the maqasid as identified through the values and norms of Islam; and therefore is in contradiction with ‘financialisation’.



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 65

From Utopia to Reality: Islamic Finance as a Hybrid Financial Sector

- In this alternative system understanding Islamic finance and banking, was assigned an important role: economic development with the objective of human well-being and social justice.
- The initial experience of Islamic finance and banking in 1960s in Egypt and Malaysia had such objectives, as they were socially oriented institutions.
- In particular since the 1990s, while the operations of Islamic finance and the nature of Islamic modes of financing have expanded, the lives of individuals have not been touched upon by this enormous growth;
- Commercial IBF has not fulfilled the developmentalist expectations;
- Thus, SOCIAL FAILURE of Islamic banking and finance is now recognised...



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 66

The Realities of Economic Development in the Top 25 Shari' ah Compliant Asset Holding Countries (2009 & 2012)

Rank	Country	Shari'ah-Compliant Assets \$m	GDP Per Capita (\$) (PPP adj.)	Human Development Index Ranking
1	Iran	293,165.8	10,955	88
2	Saudi Arabia	127,896.1	22,935	59
3	Malaysia	86,288.2	13,518	66
4	UAE	84,036.5	54,626	35
5	Kuwait	67,630.2	47,812	31
6	Bahrain	46,159.4	29,723	39
7	Qatar	27,515.4	74,882	33
8	UK	19,410.5	35,130	21
9	Turkey	17,827.5	12,955	79
10	Bangladesh	7,453.3	1,241	146
11	Sudan	7,151.1	2,086	150
12	Egypt	6,299.7	5,349	123
13	Pakistan	5,126.1	2,496	141
14	Jordan	4,621.6	4,901	96
15	Syria	3,838.8	4,511	107
16	Iraq	3,815	-	-
17	Indonesia	3,388.2	3,712	111
18	Brunei	3,201.4	50,200	30
19	Yemen	1,318.3	2,335	140
20	Switzerland	1,040.6	40,658	9
21	Mauritius	943.5	11,296	81
22	Algeria	837.5	7,740	104
23	Tunisia	632.3	7,521	98
24	Singapore	618	49,704	23
25	Thailand	495.5	8,135	87



Rank	Country	Shari'ah-Compliant Assets \$m	GDP Per Capita (\$) (PPP adj.)	Human Development Index Ranking
1	Iran	465,574.92	10,695	76
2	Malaysia	221,025.52	13,676	64
2	Saudi Arabia	185,223.00	22,616	57
4	UAE	89,390.38	42,716	41
5	Kuwait	78,587.25	52,793	54
6	Bahrain	62,171.53	19,154	48
7	Qatar	45,301.30	87,478	36
8	Turkey	29,292.86	13,710	90
9	UK	18,605.43	32,538	26
10	Indonesia	15,963.97	4,154	121
11	Bangladesh	12,572.96	1,785	146
12	Sudan	9,825.83	1,848	171
13	Egypt	8,296.32	5,401	112
14	Pakistan	7,238.34	2,566	146
15	Switzerland	6,551.37	40,527	9
16	Jordan	6,386.38	5,272	100
17	Brunei	4,693.00	45,690	30
18	Thailand	4,161.91	7,722	103
19	Yemen	2,392.49	1,820	160
20	Syria	1,888.66	4,674	116
16	Iraq	1,531.63	3,557	131
23	Tunisia	523.00	8,103	94
24	Singapore	-	52,613	18
22	Algeria	-	7,418	93

Mehr

Testing the Assigned Values of Islamic Finance

Regarding the first objective of community banking,

- The real life experience shows that Islamic finance has not done much to contribute to capacity building in the communities.

On the contrary, Islamic banking and finance has aimed at becoming part of the international markets, despite the imposed social identity “Islamic banks are quick to point out that they are not charitable organizations, and that they must turn a profit”.

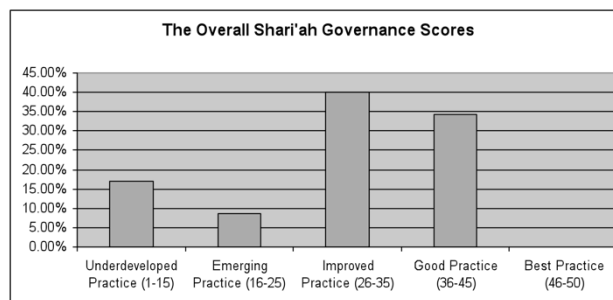


Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 68

Testing the Assigned Values of Islamic Finance

Regarding Islamic finance being responsible finance:

- There is not a universally accepted regulatory body, which can systematically check on financial providers. The initiatives by AAOIFI and IFSB remain weak and are not generally accepted.
- A study investigating Shari'ah governance of IBFs in relation to IFSB rules shows that there is no best practice in IBF.



Source: Z.Hasan (2012)

Testing the Assigned Values of Islamic Finance

As part of restraining indebtedness,

- the data indicates that IBF institutions prefer transactions, which are debt financing oriented, as they are more profitable. Thus, this claim is not fulfilled either.
- IBFs prefer murabahah as against musharakah or mudarabah.
- Propensity towards debt-based financing is evidenced further with the new financing methods such as tawarruq; even criticism raised against sukuk...
- Indeed, it can be seen that Islamic banks and financial institutions have opted profitable Islamic financing such as *murabahah* instead of *musharakah* and *mudaraha* (PLS and participatory) for instance. This is important as this indicates that difference in the orientation of Islamic finance.

Testing the Assigned Values of Islamic Finance

In relation to ethical investment,

- Restraining the investment areas of Islamic finance does not necessarily makes Islamic finance ethical, but only implies that Islamic finance fulfils the legal expectations as the screening of Islamic investment is part of the *Shari'ah*, which makes Islamic finance only 'active' in the CSR framework.

However, considering that ethicality refers to be 'pro-active' in the case of IBFs, there is no much indication that IBFs are ethical as such. This again refers to CSR initiatives, as recent studies on CSR of IBF demonstrate that they have not pro-actively developed such an understanding and their perceptions of CSR remains within the framework of *zakah* distribution and other non systemic charitable activities (Sarially, 2005).

Testing the Assigned Values of Islamic Finance

- Also poor CSR scores, as there is no proactive dynamic understanding of social responsibility is the prevailing attitudes amongst the IBFI.
- The close scrutiny of Islamic financing indicates that the social dimension is limited with their *zakah* and other charitable activities, which does not imply any systematic economic development and social justice programme aiming at capacity building.

Testing the Assigned Values of Islamic Finance

As an alternative paradigm,

- Islamic finance is no longer part of the Islamic Moral Economy system understanding, and therefore does not have macroeconomic consequences.

In addition, claiming that it links financial services to the productive side of the economy is not convincing either taking into account that the most preferred financing is debt financing as opposed to the original expectations that it would be equity financing undermines this claim too.

Testing the Assigned Values of Islamic Finance

Regarding being moral compass:

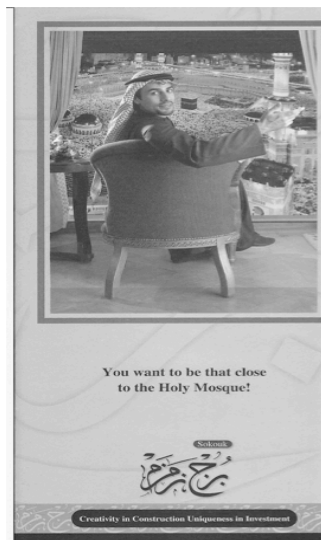
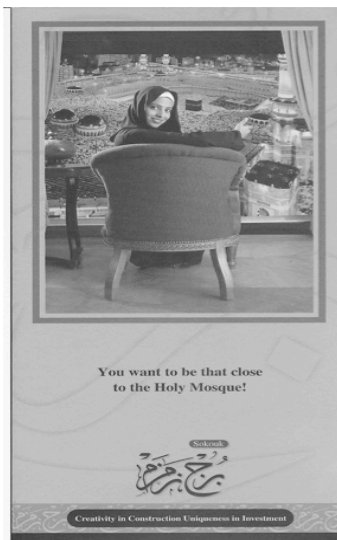
- Becoming part of the international financial system through hybridisation, it is difficult to state that Islamic finance plays the role of a moral compass for capitalism. On the contrary, it seems that Islamic finance has much to learn from conventional finance in terms of ethical and CSR financing issues.

Testing the Assigned Values of Islamic Finance

As regards to fulfilling aspirations,

- Islamic finance has not affected the social capacity building, and therefore has not been involved in widening ownership, which could have been possible through venture capital or profit-loss sharing type of investments.

An Example in the Social Failure of Islamic Financing



Zamzam Towers right before Kabah in Makkah financed through Islamic Finance. Even the advertisement indicates that the project is not socially and religiously right; as it undermines equal opportunity in this most holy place; undermines the spirituality of the place; undermines the historicity and environment

Sources of the Divergence between the Form and Substance (Aspirations vs Realities)

- IBF locating itself within neoclassical economy rather than Islamic moral economy oriented developmentalist objectives; neoclassical economy refers to efficiency while Islamic moral economy refers to equity and social and economic optimality;
- The legalistic-rational method applied by the Shariah scholar, which by definition ignores the substance by prioritising the form; as substance requires a consequentilistic approach; thus, 'form' vs 'substance' is the current debate;
- The narrow definition of maqasid which is confined to protection of limited items (Ghazalian position vs the Ibn Kayyim position);
- Commercial IBF taken as a model; hence **financialisation** of IBF as opposed to 'financing' understanding of Islamic moral economy;
- The shortcomings in the theoretical attempt to formulate Islamic finance in accordance with Islamic moral economy; mis-defined objectives;
- Observed inconsistency between aims (as defined by Islamic moral economy) and tool/instrument (bank as an profit maximising institution); bank and financial institution perhaps not the best institutions to serve according to the Islamic moral economy.



Mehmet Asutay, *Islamic Moral Economy Foundation of Islamic Finance* 77

Sources of Social Failure (I): Moving From Islamic Moral Economy to Islamic Finance

- In its current state, Islamic finance does not seem to share the foundational claims of Islamic Moral Economy, despite the fact that the founding fathers of Islamic Moral Economy, in a modern sense, aimed at creating an Islamic economic system with Islamic finance being the operational aspect of that system.
- The result, therefore, has been the divergence between the assumptions, normative principles and aspirations of Islamic Moral Economy as a system and Islamic finance as an instrument of that system.



Mehmet Asutay, *Islamic Moral Economy Foundation of Islamic Finance* 78

Sources of Social Failure (I): Moving From Islamic Moral Economy to Islamic Finance

- In this alternative system understanding Islamic finance and banking, was assigned an important role: economic development with the objective of human well-being and social justice.
- The initial experience of Islamic finance and banking in Egypt and Malaysia had such objectives, as they were socially oriented institutions.
- In particular since the 1990s, while the operations of Islamic finance and the nature of Islamic modes of financing have expanded, the lives of individuals have not been touched upon by this enormous growth.
- The result, therefore, has been the divergence between the assumptions, normative principles and aspirations of Islamic Moral Economy as a system and Islamic finance as an instrument of that system.
- Islamic moral economy's objective of economic development and attempting to achieve this through banks indicates an inconsistency.



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 79

Sources of Social Failure (I): Moving From Islamic Moral Economy to Islamic Finance

- The realities of financial markets which prioritise economic incentives rather than religious behavioural norms has forced the Islamic finance to become part of the international financial system, in which it is recognised as heterogenisation of financial products deprived of their value system.
- Since the 1990s, therefore, Islamic finance represents hybrid financial products of the international financial system.
- Thus, the difference has been reduced to technicality, and the value system is no longer mentioned beyond describing the prohibition of *riba* in quotation verses from the *Qur'an*.
- Islamic finance, hence, in its deviation from the norms and axioms of Islamic Moral Economy followed a realistic attitude based on positivism rather than normativeness; and hence has given up the utopia imposed on or assigned to itself by Islamic Moral Economy.



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 80

Sources of Social Failure (I): Moving From Islamic Moral Economy to Islamic Finance

- Thus, Islamic moral economy aims at Islam based financing solution, Islamic finance produces Shari'ah compliant financialisation;
- Hence, **financialisation vs financing**;
- While financing relates to real economy as to the financing real economy, financialisation relates to another entity aiming to create money and wealth from the non-existing financial resources, which has brought the global financial system into crisis;
- With the financialisation in Islamic finance, the fear is that similar consequences might be experienced in Islamic finance as well.

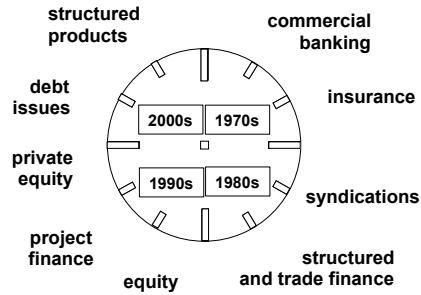
Sources of Social Failure (2): Commercialisation and Financialisation

- Commercial IBF taken as a model; hence financialisation of IBF as opposed to 'financing' understanding of Islamic moral economy; and thus, IBF is considered re-generating capitalism within Shari'ah compliancy rather than prioritising the aspirations of Islamic moral economy

Sources of Social Failure (2): Commercialisation and Financialisation

Commercialisation has required replicating conventional banking product

1950s	<ul style="list-style-type: none"> - Development of theoretical framework - Muslim-majority nation independence
60s	<ul style="list-style-type: none"> - Egypt and Malaysia pioneering institutions - Establishment of the OIC
70s	<ul style="list-style-type: none"> - Islamic Development Bank and DIB - One country-one bank setup
80s	<ul style="list-style-type: none"> - Advancement of Islamic products - Full "Islamization" of Iran, Pakistan and Sudan
90s	<ul style="list-style-type: none"> - Entry of global institutions e.g. HSBC Amanah
00s	<ul style="list-style-type: none"> - Tipping point reached in some markets - Development of industry-building institutions

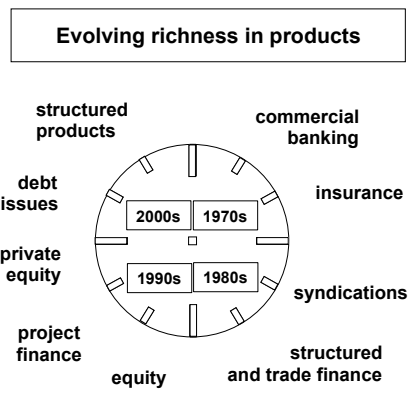


Industry has near like-for-like parity with conventional offering

Sources of Social Failure (2): Commercialisation and Financialisation

Commercialisation has required replicating conventional banking product

Development of industry	
1950s	<ul style="list-style-type: none"> - Development of theoretical framework - Muslim-majority nation independence
60s	<ul style="list-style-type: none"> - Egypt and Malaysia pioneering institutions - Establishment of the OIC
70s	<ul style="list-style-type: none"> - Islamic Development Bank and DIB - One country-one bank setup
80s	<ul style="list-style-type: none"> - Advancement of Islamic products - Full "Islamization" of Iran, Pakistan and Sudan
90s	<ul style="list-style-type: none"> - Entry of global institutions e.g. HSBC Amanah
00s	<ul style="list-style-type: none"> - Tipping point reached in some markets - Development of industry-building institutions



Industry has near like-for-like parity with conventional offering

Sources of Social Failure (2): Commercialisation and Financialisation

Shari' a-based financing adheres to the inherent principles of the Islamic tenets


Islamic finance has developed by remaining competitive with market demands...

- Competitive pricing
- Familiar risk/return profile
- "Buy-now-pay-later" mentality
- Conducive to debt finance

...however the spirit of Shari' a principles has lagged from its ideals

- Profit-loss share financing
- Asset price risk sharing
- "Save-now-buy-later" culture
- Discouragement of debt

What is needed is a mindset shift



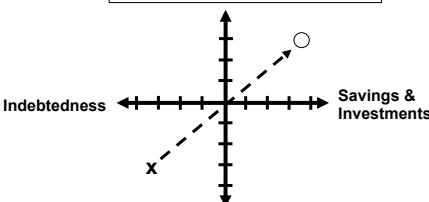
Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 85

Sources of Social Failure (2): Commercialisation and Financialisation

A Shari' a-based mindset is critical for product innovation

Shariah-based solutions

- Income-sharing products
- Shift from debt-based product offering



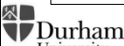
Shariah-compliant products

- Letter of the law
- Replicating conventional credit service offering

Examples

- Venture capital and private equity vehicles and instruments to enable "real economy" play
- Hedging instruments for risk management using risk pooling concepts of Takaful
- Savings scheme using infrastructure projects as sources of investment return
- Substitute commodity-based financing products with specific asset-backed/linked products
- Debt-based products to be marketed responsibly and provided conservatively

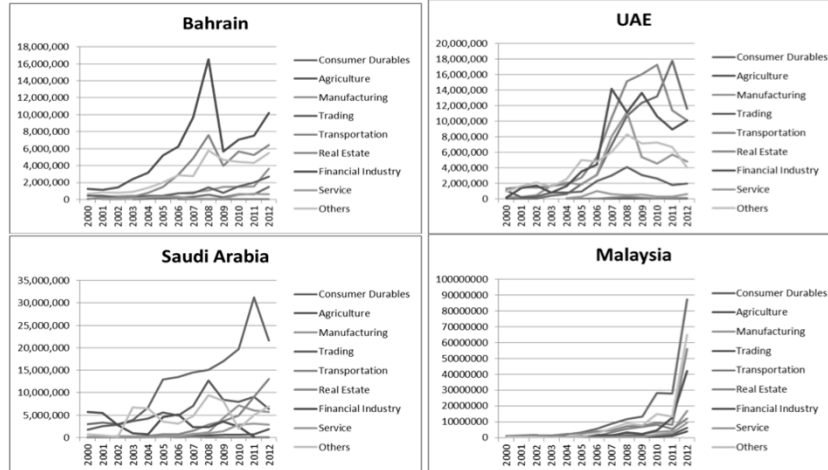
Significant scope to improve the quality of product proposition



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 86

Sources of Social and Developmentalist Failure of IBF (2): Commercialisation and Financialisation

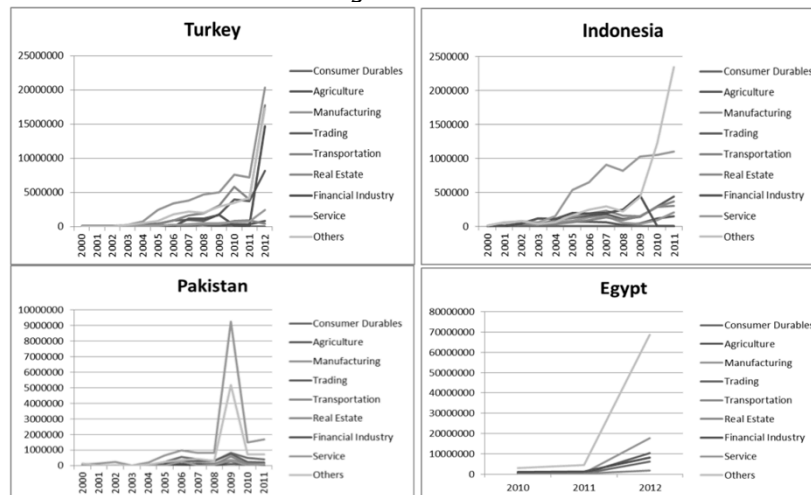
The Distribution of Islamic Financing in IBs and Financialisation



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance | 87

Sources of Social and Developmentalist Failure of IBF (2): Commercialisation and Financialisation

The Distribution of Islamic Financing in IBs and Financialisation



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance | 88

Sources of Social Failure (2): Commercialisation and Financialisation

Islamic financing methods in 2010 for selected banks

Industry sector	ABCIslamicBa	AlRajhiBank	BahrainIslamic	BankIslamMal	BankMuamlatl	Dubaisla	GFH	KFH	AlMeezanBank	QatarIslamicBa
Manufacturing	36.4%	6.4%		6.4%	2.1%	15.6%		19.9%		3.77
Construction	2.0%	9.9%		4.1%	7.9%			27.65%		1.5%
Trading	2.4%				5.4%	4.7%				26.83
Banks and financial i	33.6%		49.3%	1.4%		5.7%	100.0%	30.6%		
Government/public personal	3.2%	0.4%			3.5%	8.1%			11.40%	11.21
Tourism	1.8%	53.2%								
Commercial real esta	19.1%									
Transportation/stora	1.5%			3.3%	8.3%				3.40%	
Commerical		19.6%	26.6%							
Services		7.9%			40.1%				2.21%	
Agriculture and fishing		1.4%		1.5%	0.8%				0.04%	
Real estate				1.5%		29.1%				
Mining and Quarrying				0.01%	4.7%					
Electricity, gas and water				1.2%	6.7%				3.62%	
Wholesale & retail trade, and hotels & restaurants				3.9%					5.85%	
Education, health and others				0.7%						
Household sector				75.8%		36.9%				49.61
Textile									32.60%	
electronics and electrical appliances									3.92%	
Exports/imports									2.26%	
Automobile and transportation									1.73%	
Chemicals and Pharmaceuticals									6.96%	
Sugar									1.64%	
Footwear and Leather garments									1.92%	
cements									6.67%	
Contracts										3.32
Other	0.1%	1.2%	24.0%	0.2%	20.4%			21.8%	14.33%	5.25
Total	100%	100%	100%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0

Source: Shafi Jan (2013)



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 89

Sources of Social and Developmentalist Failure of IBF (3): Institutional Objectives vs Islamic Moral Economy

Observed inconsistency between aims (as defined by Islamic moral economy) and tool/instrument (bank as an profit maximising institution); bank and financial institution perhaps not the best institutions to serve according to the Islamic moral economy.

Thus, the issue is: efficiency vs equity (institutional objective vs societal development)



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 90

Sources of Social and Developmentalist Failure of IBF (4): Incomplete Theoretising

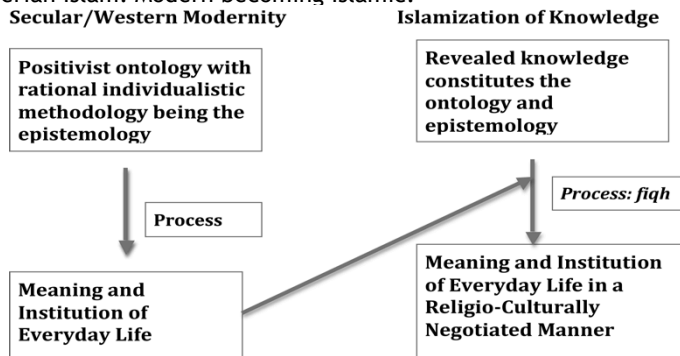
The shortcomings in the theoretical attempt to formulate Islamic finance in accordance with Islamic moral economy; Islamic economics is an incomplete attempt in theoretising;



Sources of Social and Developmentalist Failure (4): Hybridisation and Mimicry

The existential question: Islamisation of knowledge aimed at Islamising the institutions of a different ontology without considering the existential question whether these institutions should be institution of Islamic construct (conflict between aims (a social economy) and tools/instruments (bank). Therefore, the islamisation of capitalism through IBF has taken place.

Weberian Islam! Modern becoming Islamic!



This paradox in current times lead to the discussion on the deviation of Islamic finance from Islamic Moral Economy, and also the distinction between Shari'ah compliant Islamic finance and Islamic based Islamic finance.



Sources of Social and Developmentalist Failure (4); Hybridisation and Mimicry

Islamic becoming modern:

Western Modernity & Co-optation

Positivism and rational individual (secular ontology and epistemology)

↓

Meaning and Institution of Everyday Life

Islamization of Knowledge

Revealed knowledge constitutes the ontology and epistemology

↓


Meaning and Institution of Everyday Life in a Religio-Culturally Negotiated Manner (Shari'ah Compliant Islamic Finance)

Process

Process: *fiqh*

Co-opting *fiqh* rules to re-produce IBF in Western legal system

The pragmatist expansion of the legal sphere of rational law in the secular systems developed an inclusionary strategy (as opposed to earlier modernity position) by providing the interpretation of Islam in a rational manner by adopting the norms of non-modern reality of Islam generating multiple modernities.




Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 93

Sources of Social and Developmentalist Failure (4): Hybridisation and Mimicry

The institutional construct of financing in the form of commercial banks have to be questioned; as Allamah Iqbal did:

A blaze of art and science lights the West
 With darkness that no Fountain of Life dispels;
 In high-reared grace, in glory in grandeur,
 The towering buildings of banks out-top the cathedral roof;
 What they call commerce is a game of dice,
 For one, profit, for millions swooping death.
 There science, philosophy, scholarship, government,
 Preach man's equality and drink men's blood.

From:
 Lenin in the Presence of God
 By Allamah Muhammad Iqbal



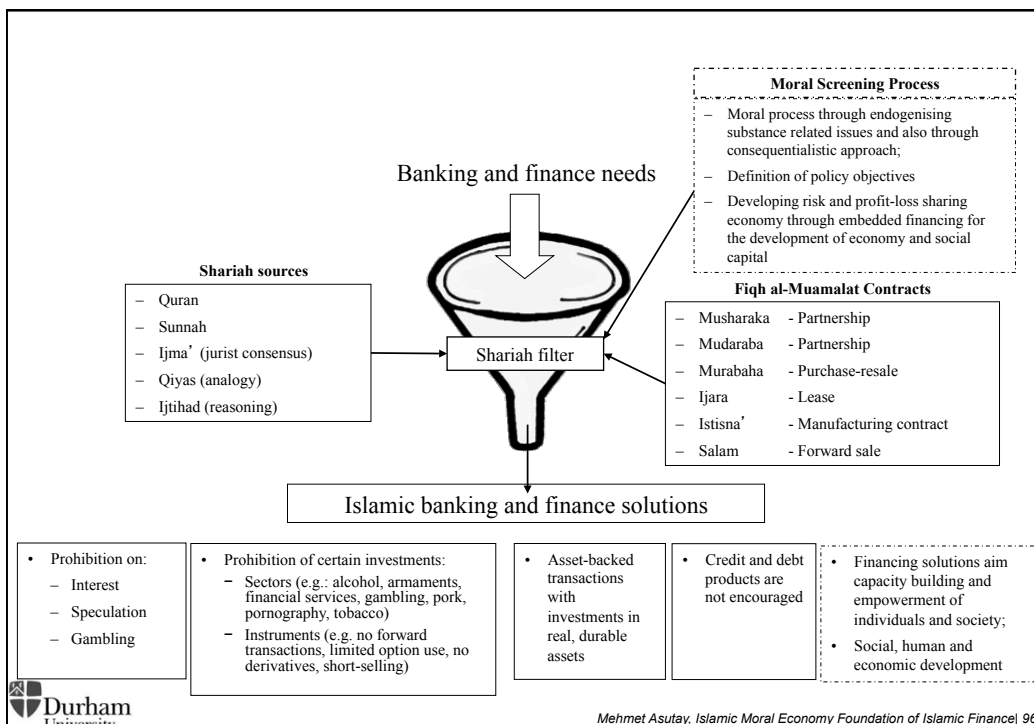
Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 94

Sources of Social and Developmentalist Failure of IBF (5): Form vs Substance

The legalistic-rational method applied by the Shari'ah scholar (*fiqhi* approach), which by definition ignores the substance (moral and consequentialist approach) by prioritising the form; as substance requires a consequentialistic approach;

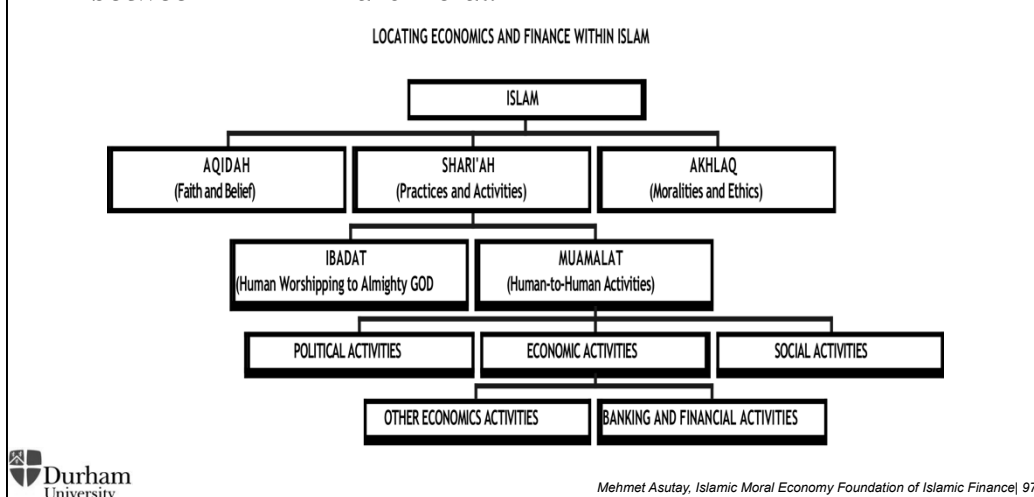
form vs substance (Ibn Kayyim's position);

"It is impossible for the Law of the Wisest of the wise [God] that He would forbid a harmful dealing [riba, or usury], curse its perpetrators and warn them of a war from God and his Messenger, and then to allow a ruse to result in the same effect with the same harm and added transaction costs in constructing the ruse to deceive God and his Messenger. This cannot be in accordance with the law, because riba on the ground is more facile and less harmful than riba with a tall ladder atop of which the two parties conduct the riba..."



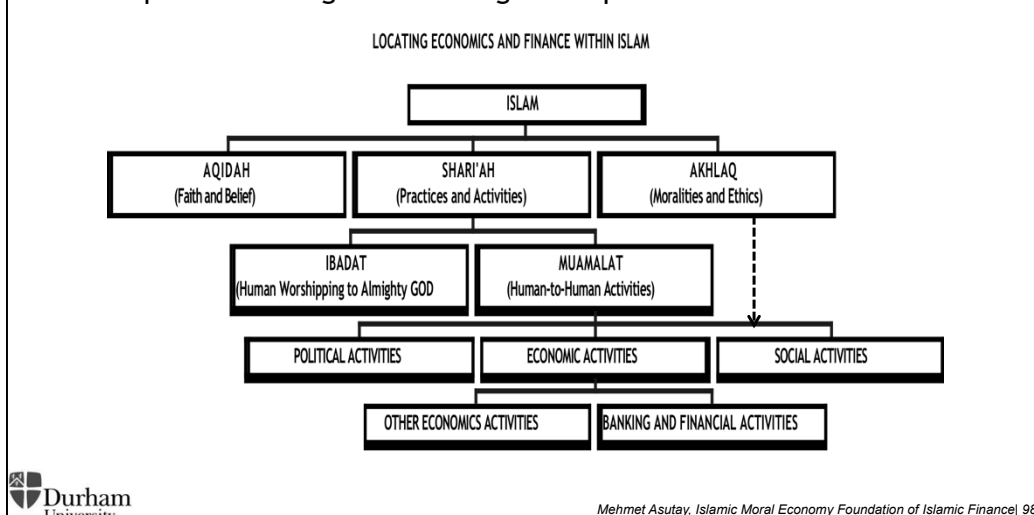
Sources of Social and Developmentalist Failure of IBF (5): Form vs Substance

The place of economics and finance matters in the taxonomy of Islamic knowledge in modern times indicates the missing link between *muamalat* and moral:



Sources of Social and Developmentalist Failure of IBF (5): Form vs Substance

As Islamic moral economy requires, moral must be endogenised in the process through considering consequences of financial actions:



Sources of Social and Developmentalist Failure of IBF (5): Form vs Substance

Lastly,

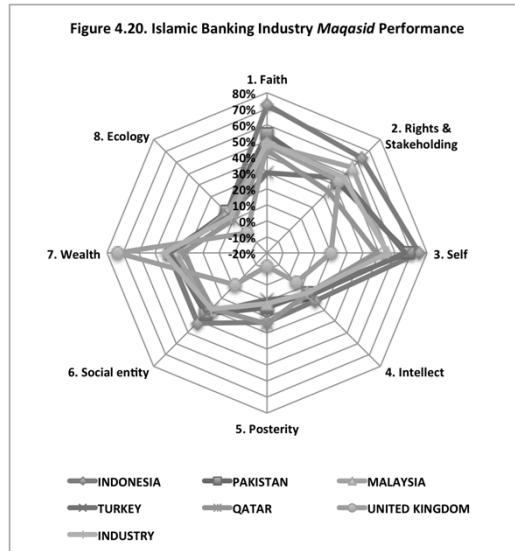
- Fiqh is related to the internal Shari'ah consistency of a financing instrument.
- However, Islamic moral economy is related to consequentialism, which also considers the outcome of the designed or manufactured financing instruments;
- Only through consequentialism, the deviation of Islamic financing from the aspirations of Islamic moral economy can be located; and reversed.

Sources of Social and Developmentalist Failure (6): Definition of Maqasid

The narrow definition of *maqasid* which is confined to protection of limited items (Ghazalian position) by definition fails as in Adam Smithian failure, and hence more proactive approach such as in Ibn Kayyim position is essential.

The evaluation of IBs through the extended maqasid does not indicate 'an Islamic performance' beyond Shari'ah compliancy:

Sources of Social and Developmentalist Failure (6): Definition of Maqasid



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance | 101

Sources of Social and Developmentalist Failure (6): Definition of Maqasid

Table 4.23. Islamic Banking Industry *Maqasid* Performance

<i>Maqasid al-Shari'ah</i>	INDONESIA		PAKISTAN		MALAYSIA		TURKEY	
	Scores	Rank Order*	Scores	Rank Order*	Scores	Rank Order*	Scores	Rank Order*
1. Faith	72.71%	2	54.45%	2	47.83%	3	29.94%	5
2. Rights & Stakeholding	63.13%	3	42.01%	3	55.45%	1	45.57%	2
3. Self	75.14%	1	67.99%	1	54.54%	2	66.00%	1
4. Intellect	22.33%	7	15.81%	7	15.16%	7	17.39%	6
5. Posterity	23.43%	6	14.23%	8	11.99%	8	9.05%	8
6. Social entity	41.99%	4	33.99%	5	30.26%	5	33.42%	4
7. Wealth	41.64%	5	39.86%	4	37.27%	4	40.61%	3
8. Ecology	15.79%	8	16.16%	6	15.37%	6	13.64%	7
Global Performance	56.83%		34.67%		33.53%		29.34%	

<i>Maqasid al-Shari'ah</i>	QATAR		UNITED KINGDOM		INDUSTRY	
	Scores	Rank Order*	Scores	Rank Order*	Scores	Rank Order*
1. Faith	44.18%	2	47.25%	2	49.39%	2
2. Rights & Stakeholding	34.46%	3	43.43%	3	47.34%	3
3. Self	48.47%	1	19.52%	4	55.28%	1
4. Intellect	15.65%	7	5.87%	6	15.37%	6
5. Posterity	24.36%	6	-12.14%	8	11.82%	7
6. Social entity	28.87%	5	8.05%	5	29.43%	5
7. Wealth	32.72%	4	73.72%	1	44.30%	4
8. Ecology	9.83%	8	-1.68%	7	11.52%	8
Global Performance	23.82%		11.44%		30.82%	

* Rank Order is determined by the performance for each Maqasid. 1 is given for the highest performance while 8 means the least performance.



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance | 102

Sources of Social and Developmentalist Failure (7): Behavioural Norms as a Reason of Social Failure

The Demand Side:

- The social failure of Islamic finance can also be explained by the pragmatist and legalistic attitude of individuals.
- The main strain in IBF is an attitude which can be described as “socially and politically conservative, seeking individual piety and social mores built around traditionalist compliance with fiqh, and looks to social and political improvements mainly as a result of that” (Vogel and Hayes, 1998: 27, footnote).
- Thus, Islamic norms have not been instrumental in shaping individual choices and preferences, which evidences again the failure of homolIslamicus.
- Mass consumption and reckless financing and economic demands from the individuals have not helped the industry driven Islamic finance to be more morally responsible.

Sources of Social and Developmentalist Failure (7): Behavioural Norms as a Reason of Social Failure

The Demand Side:

See the perceptions of the Islamic bank customers on some crucial issues:

Summary of Respondents opinion towards acceptability of characteristics of Profit-sharing in Deposits account

	Those who are familiar with Profit-sharing Deposit Account	
	Yes	No
Concern about deposit return?	73.2%	26.8%
Agree Extra Profit Generated transferred to PER?	54.5%	45.5%
Agree PER being used for future return stability?	64.4%	35.6%
Prefer your deposits to be guaranteed by the Government?	67.9%	32.1%

Source: S. Mohd Karim (2010)

Thus: homolIslamicus = homoeconomics!

Sources of Social and Developmentalist Failure (7): Behavioural Norms as a Reason of Social Failure

And expectational paradoxes:

In a recent study on Malaysia, participants were asked to list their expectations from IBF, which in the following tables indicates developmentalist expectations from these institutions.

Dimensions of CSR	Mean	Dimensions of CSR	Mean
Emphasis on ethical values and moral behaviour (e.g. honesty, respect, justice, etc.)	4.34	Charity/donation to the community	4.12
Ensure investment in ethical and Shari'ah compliance products	4.34	Pro-active in environment conservation	4.11
Provides educational sponsorships	4.27	Promote health and safety in the workplace	4.08
Alliance with charitable organisations (e.g. activities with orphanage, helping the poor, etc.)	4.19	Actively target groups, communities or institutions that require assistance	4.08
Assist Zakah House (<i>pusat zakat</i>) for zakah collection and/or distribution	4.19	Provide benevolence loans (<i>qard al-hasan</i>)	4.04
Guarantees investment will not harm environment	4.17	None of the above, as bank is a financial institution	2.31
Adoption of best practices in human resource management	4.13		

Source: S. Mohd Nor (2011)



Sources of Social and Developmentalist Failure (7): Behavioural Norms as a Reason of Social Failure

In the same study participants were asked to express their opinion on the potential benefits of CSR for IBFs, which are depicted in the following table:

	Mean		Mean
Being socially responsible gives better brand image to the bank	4.21	Implementing CSR creates competitive advantage for the bank	3.96
By practising CSR, the bank overcomes the barrier between bank and society	4.04	Contributing to CSR increases appreciation of stakeholders	3.94
Through CSR activities, bank increases the awareness to be environmentally friendly	4.00	Practising CSR will increase employees satisfaction in the bank	3.81
By implementing CSR, bank promises a better future for the community	3.98	CSR will help increase annual profit for the bank	3.53
Being a socially responsible bank, will increase loyalty among customers/depositors	3.97	Implementing CSR practices are costly and only suitable for a financially stable entity	2.98

Source: S. Mohd Nor (2011)



Sources of Social and Developmentalist Failure (7): Behavioural Norms as a Reason of Social Failure

In the same study participants were asked to express their opinion on the **Factors Preventing Islamic Banks from Implementing CSR**, which are depicted in the following table:

	Mean
Lack of commitment for CSR	3.87
Not prioritised as important	3.76
Lack of commitment to Islamic ethics	3.73
Commercial orientation	3.71
Bureaucracy	3.68
Lack of awareness	3.66
Not imposed by the government	3.59
Lack of adequate information on CSR	3.58
Not interested	3.54
Not profitable to the bank	3.44
Lack of human resources	3.40
Time constraint	3.34

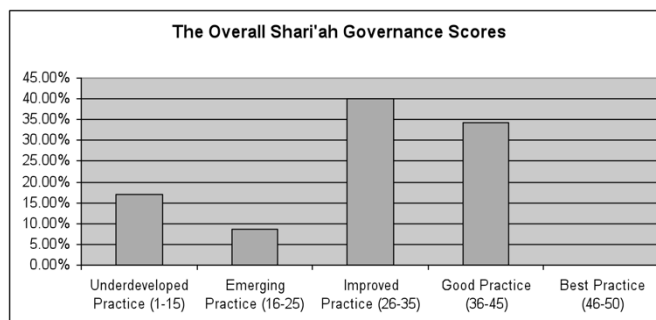
Source: S. Mohd Nor (2011)



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 107

Sources of Social and Developmentalist Failure (8): Islamic Finance being Responsible Finance

- There is not a universally accepted regulatory body, which can systematically check on financial providers. The initiatives by AAOIFI and IFSB remain weak and are not generally accepted.
- A study investigating Shari'ah governance of IBFs in relation to IFSB rules shows that there is no best practice in IBF.



Mehmet Asutay, Islamic Moral Economy Foundation of Islamic Finance| 108

Sources of Social and Developmentalist Failure (8): Islamic Finance being Responsible Finance

- Corporate Governance Performance, new empirical results (53 lbs):

Overall-Country Level Results for all the of CG Disclosure Dimensions

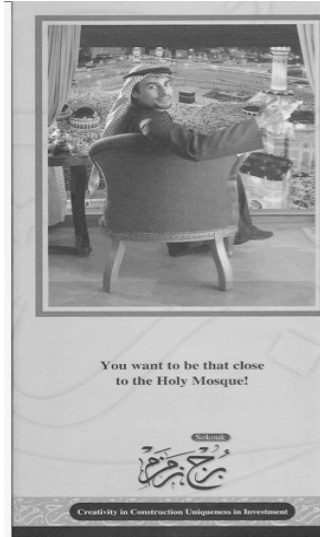
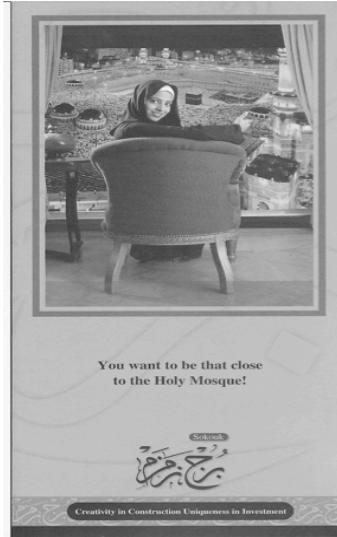
COUNTRY	Overall CGI	COUNTRY	Overall CGI	COUNTRY	Overall CGI
Malaysia	0.620	Turkey	0.283	Bangladesh	0.152
Bahrain	0.520	Saudi	0.233	Sudan	0.065
Jordan	0.508	UAE	0.216	Egypt	0.060
Indonesia	0.378	Pakistan	0.196	Kuwait	0.040
UK	0.303	Qatar	0.166	Yemen	0.027

Mean: 0.25

Sources of Social and Developmentalist Failure (8): Islamic Finance being Responsible Finance:

- Also poor CSR scores, as there is no proactive dynamic understanding of social responsibility is the prevailing attitudes amongst the IBFI.
- The close scrutiny of Islamic financing indicates that the social dimension is limited with their *zakah* and other charitable activities, which does not imply any systematic economic development and social justice programme aiming at capacity building.

An Example in the SOCIAL Failure of Islamic Financing



Zamzam Towers right before Kabah in Makkah financed through Islamic Finance. Even the advertisement indicates that the project is not socially and religiously right; as it undermines equal opportunity in this most holy place; undermines the spirituality of the place; undermines the historicity and environment

Conclusion (1)

Consequently:

While referring to the *Qur'an* and locating the principles governing Islamic finance in *Qur'an* refers to authenticity, consequences of Islamic finance do not show success in the intended meaning of this authenticity or *Shari'ah* as located in the aspirational notions of Islamic Moral Economy.

And therefore,

IBFs also will not able fulfil the expectations of the lady protesting in the Wall Street; as IBF as a model and institution is as financial and as commercial as conventional finance

Conclusion (2)

- Correcting the failure of Islamic finance, which has deviated from the aims of Islamic moral economy by giving way to the financial incentives, should be in the form of introducing further but robust social justice oriented principles into Islamic finance by endogenising social justice into its operational nature as in the example of social banks.
- There is a need to go beyond the legal interpretations and reading of the text; as value and objective oriented approach would help to overcome the growing tension between the performance of Islamic finance and the utopia of Islamic economics.
- By using the analogy of the neo-classical theory, IBFs have to move into the third stage of institutional development by introducing social banking into the market.
- In addition, other non-banking Islamic financial institutions should be considered including microfinance, waqf and zakah funds.

Conclusion (3)

- This is the objective of Islamic moral economy also: to create an equilibrium between the scarce resources and unlimited needs through a moral filter system by producing a socially and financially optimal state of the economy in which human well-being is served through inclusive growth policies and value-added creation oriented economic activity;
- Endogenising ethics, thus, can provide the new identity based on substantive and ethical religious tenets.
- In reorienting towards social banking, the 'Islamic' in 'Islamic finance' should relate to the social and economic ends of financial transactions, rather than the contract mechanics through which financial ends are achieved.

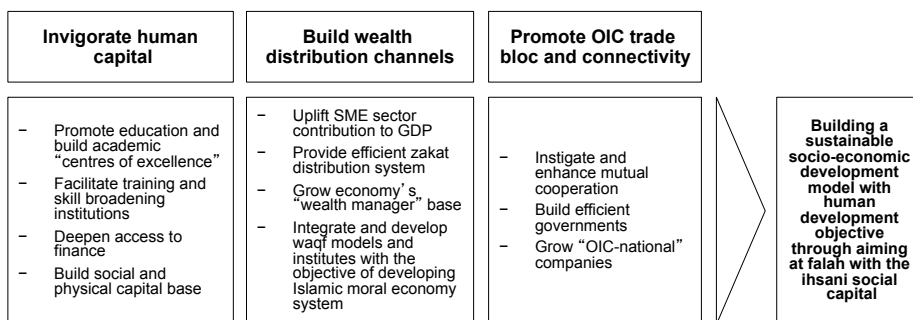
Conclusion (4)

- **Commercialisation and market pressures has shaped industry’s development to date**
 - Competitive forces have ensured replication of conventional offering
 - Global regulators initially dismissive, now “no obstacles, no favours”
 - Global debt-friendly monetary system has hampered development of equity based propositions
- **Islamic finance should embrace an evolving role**
 - Industry should perform role of asset managers with socio-economic banking
 - Shariah-based vision is next stage of industry development: from replication to innovation
 - Islamic financial institutions have an important role to play in the Islamic world’s development

The distinctiveness of Islamic finance should be preserved to make a meaningful change



Conclusion: The Industry Has a Key Role to Play in the Path Towards Economic Development



Islamic banking is one tool to enable economic development



For socially and environmentally responsible value oriented just economic and financing system, which can enable individuals to function and which can aim at well-beings of individuals..

Utopias should exist so that realities can be constructed and engineered..

Thank you..