Islamic Economics Compared to Socialist, Fascist and Capitalist views on Economy as a System

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Chapter 1

Islamic Economics Compared to Socialist, Fascist and Capitalist views on Economy as a System

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Abstract. This chapter aims at comparing the major Islamic views on economy to previously experienced views such as socialist, fascist and capitalist attitudes. The role of government, interest rates, public and private property rights and regulations, implementation difficulties, market mechanism and financial management, wealth accumulation are the main areas of concern in this paper. This chapter is a short extract taken from the master thesis advised by F. Özlen Hiç "AN INQUIRY FOR THE VALIDITY OF EFFICIENT MARKET HYPOTHESIS IN DEVELOPED AND DEVELOPING COUNTRIES AND A COMPARATIVE ANALYSIS ON STRUCTURAL AND SOCIAL CHANGES IN ECONOMIC SYSTEMS SUGGESTED FOR IMPLEMENTATION" – 2020.

Keywords. Islamic economics, wealth accumulation, capitalism, property rights, interest rates

1.1 Introduction

The Islamic Economics being utilized as a term to denote financial transaction rules or diverse economic activities was allowed and supported by Sharia by which Quran and Sunnah are meant according to which major economic decisions are made regarding things needed, allowed, restricted, motivated or discouraged.

Quran, Sunnah-driven moral frames besides behavior patterns, accumulating zakat besides different tax types, interest –riba for debt being totally prohibited, Qimar – gambling - speculation not having any bases of proper analysis of information available, and Taa'won – mutual cooperation, Gharar- referring uncertain or highly risky state created by one party on purpose or by unplanned deficiency of necessary data with the chance affecting final result of the contract; for instance, duties and rights of sides of contract, product specification related to information such as quantity, price, or quality to be withheld - are considered to be the central features of Islamic Economics.

1.2 The Working of Islamic Economics

Islamic economics paves the third way – a fair mean between capitalism and socialism eliminating the cons of both. Islamic Economics aims to realize economic activities according to the orders of Allah in individual lives, community life and at the Ummah level - micro and macro levels accordingly.

1.2.1 Ownership of Property

Property being one of the major defining features of an economic system, is of two kinds, namely public, state, and private property in Islamic economics as well. The former denotes to resources found in nature, for instance, woods, water, land, oceans enabling every individual to have equal rights for, since they are thought to be proprietorship of common type belonging to all in society in an Islamic economic view.

Public property can be utilized by everyone under the fact that it poses no restriction or limitation to others' rights, is under control and protection of the Islamic state. When it comes to making public property private or national, it is still debatable among Islamic scholars.

State property being both movable and immovable including definite natural resources besides some other property types which cannot immediately be privatized, can be obtained through conquest or peaceful ways with no exception of non-claimed land even being non-cultivated. 1/5th of armed weapons and tools taken during the battle was taken as state property during the life of the prophet, which was the same for the conquered land as well. The reason behind having this property as a state property and not privatizing is that it would lead to the concentration of resources in a few hands preventing it profiting community. Thus, proprietorship remains under cultivator invasion during tax collection with the purpose of government treasure.

1.2.2 Taxation

Since taxation, inheritance, prohibition against stealing - imposing strict punishments on thieves Islam protects property rights, legality of ownership, charity recommendation and some other private property related topics are pointed out in Quran, it is clarified that private ownership is recognized in Islamic economics.

Private Property is categorized as involuntary (inheritance, bequests, gifts), non-contractual (utilization of natural resources primarily unclaimed to be personal property), and contractual (trade, rent, hire labour etc.) according Islamic Economics.

In case private ownership causes some sort of threat to the general community good, the state considering the public interest is given the right to restrict proportion a person is permitted to possess – having a similar feature with the community interest seeking communism and still differing from nation prioritizing fascism in the point of being just to people belonging to any nation not only to a specific one -, according to some supporters of Islamic Economics, namely Maliki and Hanbali jurists, still being as a matter of debate among others.

1.2.3 Market Mechanism

According to Nomani and Rahnema, in the view of Islamic economics, markets are considered to be essential mechanism of coordination in system, since under perfect competition conditions buyers are able to get goods that meet their willingness and expectations, and sellers are able to sell at a desired price. In an operating market three main conditions are considered significant, which are freedom of exchange encouraging trade and rejecting the assumption of its being forbidden, individual proprietorship and contract security calling for fulfillment of contracts, especially commercial ones dealing with immediate and future payments being the main concentration point.

Manipulating market by such as increasing prices by creating shortage artificially, overbidding with price increase aim, hiding significant data from the contractor are prohibited in Islamic Economics. Price setting, hoarding, monopoly, market entry barriers and bribery as forms of market manipulation are forbidden or at least discouraged in Islamic economics, when it comes to state interference, it is allowed given certain conditions.

1.2.4 Land, Labor, Capital

In Islamic Economics individuals are given certain socioeconomic rights that prove this economic system to be based on the sense of justice such as enabling the individuals to have access to the production factors which are land, labor, capital (economic justice), to be heard (legal justice), and provided with education, usual requirements, public property use, safety and others (fair society), however, to what extent these rights are accomplished and respected will to a great extent be as the duty of the ruler(s) of the time dependent on the one(s) in power at that time.

Compared to capitalism in which the individuals are considered to be the direct owners of private property, and socialism in which the individuals are seen as collective owners of all the property, in Islamic Economics individuals, however, treat the property in their control as all the property belongs to God Almighty according to the religious belief, and despite being legal owners of the property, in this belief, they will be accountable for the use of the property on the Judgement Day.

1.2.5 Interest

Interest-riba, being explained as extra amount for borrowed or lent money, in conventional economic systems, was obtained by the lenders since they provided loans for a pre-defined period, however, in Islamic economics any kind of interest are prohibited due to its exploiting the weak leading to the wealth accumulation in a few hands as a result of which a class distinction is created by expanding the gap between well-off and sufferers of poverty.

Islamic economics prohibits interest, owing to giving an increase for zero-risk capital, on the other hand, provides another form of finance which is a deal based on sharing both profit and loss in economic operations. Apart from interest, profit and loss sharing are a concept giving rise to the risk-based capital. Profit and loss sharing form enables pre-determined balance such as 50/50 or 80/20 etc., which means in this form no percentage from profit is a point, but previously decided certain amount or ratio.

When it comes to loss, share division is on the base of capital contribution. To clarify, in a scenario in which investor provides all capital and the manager runs the business, profit sharing happens under pre-determined ratio for instance 60/40. In terms of loss, the investor is expected to confront capital loss, since the manager experiences a loss as well in the form of resources such as labour, time and energy having been wasted for business. No return on capital can be fixed or pre-agreed. Consequently, profit portion must be legitimized by risk sharing in case loss occurs.

1.2.6 Efficiency vs. Equality

In Islamic Economics belief in Allah is what regulates social duties such as equality and fairness. Contracts are known to be the major element in social trust. Thus, if parties fulfill their duties as mentioned in the contract social trust prospers, however, in the contrary case scenario trust gets damaged as a result affecting social and economic ties negatively. Besides all, Islamic economics is strongly against financial transactions not generating economic activities. It is expected for each financial transaction to be profiting plus halal in wealth creation of an individual besides bringing benefits to the community in general such as creating work positions, developing conditions. Wealth accumulation is prohibited in Islamic approach due to ending with poverty deprivation of basic social rights. Money considered potential capital, plus, driving force in economy is believed to circulate in economy in order to activate and keep this flow active.

Thus, Islamic economics is against wastage, on the contrary, supports investment in halal businesses. Investors get the reward of fixed capital payback, being often cases guarantee in traditional economies. Award is dependent on risk taken by investors and asset performance in Islamic finance and economic management. Prohibition of paper-based transactions in Islamic Economics is due to not generating increasing wealth besides being negative to community in general.

When it comes to wealth acquisition, either utilized land, labor, capital or heritage can be the ways according to Islamic Economics. Hence, illegal ways of wealth making such as corrupting, human right violation, exploitation of the ones in poverty is prohibited. Participating in charity with the aim of decreasing distinction between "haves" and "have-nots" is strongly encouraged in Islamic Economic Management. Hence, according to the notion of Zakat, every individual is expected to spend 2.5% of their net wealth for the needy ones. By "wealth" extra amount after meeting consumption needs is meant.

In Islam not existing items are not allowed to be sold. In the modern-day reality, it is an all-known fact that the mere thought about the slight interest rate fluctuation brings immediate destruction to all areas of economy demonstrating the point of significance interest rates have in the economy.

First of all, this is what motivates to save and second of all, allocates capital. To get into details, saving is a vital point of any economy due to its relation to investment rate relatedly, growth rate in the economy. Since saving of too much as too little is inefficient, interest rates, in this regard, becomes a tool to control the rate of saving and keep the right balance depending on the economic conditions. In terms of the distributive function of interest, interest rate is believed to have an intrinsic role in the evaluation of investment project possibility plus various rare resource use. Owing to capital scarcity, a tool directing resource to produce the highest return is required.

In case of misdirection, it is quite possible for capital to be used for less significant projects, leaving significant ones with no investment capital. Having interest rate as a regulation tool, anticipated benefits are compared to interest rate bringing out a case in which only projects with more profits than "cost" are financed including self-financing because of interest playing "alternative" for other investment opportunities for example opportunity cost.

On the other hand, efficiency being an objective of every modern economy, each economy struggles to have the best possible resource allocation to achieve maximum overall return- growth rate since no interest equals to a very low rate of saving ending up with inefficient use of scarce resources.

Since interest is not allowed in Islamic economics, there is such a strong claim that an interest free system is not feasible only, also, superior to interest-based one. As was mentioned previously, interest is the triggering point for saving, since absence of interest brings low rate of saving. However, it is not the one and only reason for saving.

Analysis of John Maynard Keynes in his General Theory clarifies the fact that the rate of saving simply depends on the amount of income. In case of a rise experienced in income, with no regard to interest rates savings will rise. Empirical studies prove the motive for saving to be in majority of the cases unrelated to the interest rate. To provide more details on the point, absence of interest rate will not bring the absence of saving, but undeniably, will result in a lower rate of saving than in case of its presence.

The role of interest rate lays more on attracting savings to the banking system, indeed, for the interest is considered to be an award given to the saver in the interest-based economic system. In case of interest-free economic system, however, savers are still rewarded, but differently from the interest based economic system. This is an undeniable fact that any banking system without this kind of reward fails to attract savings in Islamic or any other system. Nevertheless, this reward is certain to be contingent on fund users' performance. To illustrate, it is expected to be in the form of profit share generated through saving utility but not in the form of a predetermined fixed return. For this reason, in Islamic economics, it is not assumed that the interest free system will bring a definite decrease in the rate of savings. The fact that compared to a conventional banking system, deposits in profit-and-loss-sharing banking system (PLS) are exposed to a higher degree of risk leaving the savers at a disadvantage in an interest free system, is only true under the circumstance that depositors having significantly higher increase rates of risk taking in a PLS system are then compensated by the higher rates of return.

Only under perfectly competitive market conditions, where marginal productivity of each project is perfectly known, plus, comparable to interest rate, interest plays a significant role of an efficient allocator, however, in reality even in the highly advanced industrial economies there is no presence of such a market, since money and capital markets suffer from the imperfections to a great extent.

Since the state effect on the market mechanism results in directing resources according to socio-political priorities away from marginal productivity not totally leaving the scarce resource allocation to the market forces and due to the point of credit-reliability of borrower making a more important sense to the lender than project possibility, many of projects with return rate exceeding the interest rate plus meeting efficiency rate criteria go unfinanced revealing one of such imperfections.

Profit rate is considered to be more relevant than interest as an indicator for efficiency and optimal resource allocation purpose, since profit rate is a real index not monetary, besides, its use decreases the dominance of financial sector over the real sector in the economy introducing stability to a great extent in the system. Despite recognition of the time value of money, it is allowed to have a monetary consideration only in certain transactions, hence, being prohibited to attach monetary value to time in sale but not in loans.

1.4 Conclusions

A question arises: Why? Income generation allowance from pure monetary transactions will lead lenders not to be involved in services and goods production , ultimately, exposing financial sector with the generated income just from time passage being independent from real sector in which the goods and services are produced ending up with dichotomy directing the income besides wealth redistribution toward one sector or another depending on economic condition with the instability guided by boom and depression periods, as a result of which injustice is created. As a common point of capitalism and Islamic economics, production due to providing employment and opportunity, is the major point of focus in order to achieve expected economic growth.

However, consumption remaining the driving engine of capitalist economic system, turns out to be of less significance in Islamic economics owing to the fact that Islam as a religious belief, or moral philosophy considered by non-Muslim groups supports a simple way of living in which consumption of unnecessary goods is not encouraged. Regarding wealth, accumulation of which is highly supported by the capitalist economies, it is strongly criticized by Islamic Economics as a source of sole motivation for business or economic activities, despite wealth acquisition still not being discouraged for including the payment of Zakat.

Government having a role as limited as possible in capitalist economies, takes higher duties under the rule of Islamic Economic Management System such as providing equal economic opportunities and freedom enabling every individual in the society to adopt any profession or business within the frames of law, fulfilling basic life necessities such as food, clothing, healthcare, education, shelter and similar ones of its kind for the needy ones in the community, and operating to keep down the activities of non-Islamic nature such as gambling, black market operations, smuggling and some others of this kind. Since interest makes the society inactive, in an interest free Islamic economic system this is also the government's responsibility to have stable prices by the help of monetary and fiscal policies.

In contrast to capitalism, which is a morally neutral system, Islamic economics is a morally directed system with no free market as in capitalism nor total proprietorship, in which individual attempt needs to be discharged on social responsibility framework, having the goal of establishment and maintenance of social welfare. Work as the basic production factor is considered to be the tool for the generation and distribution of wealth and, thus, money as an exchange tool plus value store is not permitted to be commodity in Islamic economic system comparably.

What makes Islamic economics difficult to implement is its being based on moral values, rather than an operational mechanism. Besides, it is easy to escape from the responsibility of Zakat, and again due to being based on moral and religious beliefs of Muslims, it is incredibly difficult to be applied in non-Muslim societies despite its advantages being accepted worldwide. A tiny disadvantageous case for the Islamic economics in modern day reality is that today's world shows a greater interest in Islamic finance rather than Islamic economics as a fully operating system.

Since in Islamic economics the followers are God-conscious being based on moral values, it is against wasting resources and squandering, on the contrary, it gives full support to diligence criticizing the laziness and idleness. Besides, it prohibits all sorts of harm on the other's property and rights considering it an aggression imposed on the people's freedom. Even if the action itself is permissible, having harmful motivation is the sufficient reason to be prohibited.

In Islamic Economics property is being protected against any foreign aggression in case of one working hard to secure his property, however, property gained by the exploitative means, the enforcement, or monopoly, harming others is no longer protected. Compared to capitalist economies in which it is enough that both parties agree to make a deal, in Islamic Economics even having both parties agreed a deal cannot be considered completed without having the permission of Shariah.

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