Islamic beliefs and Economic Institutions

- closer to capitalism than socialism
- utility of a good Muslim
  - consideration of an action to the immediate effect and its effect on the life hereafter
  1. avoidance of (______)
  2. payment of (______)
  3. respecting Islamic norms

Background

- capitalism → pursuit of wealth
  - wealth used as a yardstick to define development and progress
- Islamic writers: "mere maximization of total output cannot be the goal of a Muslim society. ... [It] ... must be accompanied by ensuring efforts directed to ... spiritual health ... justice and fair play."
- an economic system that is compatible with Islam
  - guided by the Islamic law
Prohibition of *ribā*
- it is unjust to earn money without assuming risk
- unclear how to apportion risk
  - risk shares should conform to customary notions of fairness
- *qirad* or _______________: “profit and loss sharing”
- informational asymmetries between the providers and users of funds
- exposes individuals to more risk
- ______ not allowed

Payment of *zākat*
- redistribution of wealth
- tax to pay for eight causes (groups)
- collection voluntary (_________________)
  - in some cases state mandated – obligatory (Saudi Arabia, Malaysia, Pakistan, ...)
- ______ of wealth above subsistence level
- not much evidence that it alleviates poverty
  - rampant corruption
  - in many cases, beneficiaries need to be “connected” and funds to go other causes

Islamic Economic Norms
- agents act under the guidance of Islamic norms
- command good and forbid evil
  - avoidance of ________, ______________ and ______________
  - discouraging activities that create harmful externalities
  - encouraging hard working, charging fair prices, and paying one’s dues to others
  - *homo economicus* → *homo__________*
- actions passed through a ________________
Islamic Economic Norms

- belief that disagreements in economic matters will be rare
  - overly optimistic
  - leaves room for individual judgment
- fairness is a relative (subjective) concept
- economic freedoms under capitalism too broad and under socialism too narrow
  - optimal constraint of economic liberties
- _____ the only country that actively incorporated Islamic norms into everyday activities

Islamic Banking

- interest (riba) is not allowed
- qirad (musharakah) is allowed and encouraged
- principal-agent problems
  - adverse selection
  - asymmetric information
- murabaha to avoid interest
- price of capital? allocation
  - centrally planned
  - set zākat rate at the opportunity cost of capital

Differences?

Nominal Returns on Saving Deposits at Turkish Banks

<table>
<thead>
<tr>
<th>Time</th>
<th>3 months</th>
<th>6 months</th>
<th>1 year</th>
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<tbody>
<tr>
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<td>Islamic</td>
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<tr>
<td>June 1990</td>
<td>11.64</td>
<td>11.48</td>
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<td>January 1991</td>
<td>13.34</td>
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<td>January 1993</td>
<td>14.72</td>
<td>13.65</td>
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</tr>
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- only cosmetic differences between conventional and Islamic banks
Macroeconomy

- How to conduct monetary policy?
  - money supply influences the rate of _____ instead of the interest rate
- Inflation – less than in capitalism
  - interest-free banking dampens __________
    - demand inflation less →
  - cost-push inflation less →

Microeconomy

- market structure
  - monopolies?
- Efficiency?
  - no _______ markets → _____ price fluctuations
    → _____ efficiency
  - no monopolies → _______
  - ______ wastage of resources and less pollution
  - ______ productivity
  - ______ resentment against the owner of capital

Still some disagreements

- property rights
  - degree of allowed private ownership
- state regulation
  - how involved should the state be
- pricing (role of the markets)
- "just wages"
- credit opportunities
  - ___
  - zākat
Conclusion

- difficult to analyze Islamic economic system a comprehensive system
- more meaningful to analyze particular institutions and constraints on decisionmaking
- Problem when reading about the Islamic economic system:
  - the Islamic economists tend to contrast the actual practices of the systems they want to discredit with the ideal operation of their favored alternative
  - translation issues