

# The Mythology of Islamic Economics and the Theology of the East Asian Economic Miracle

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## ABSTRACT

This paper examines how the equation of Islamic economics with interest-free banking in the current discourse has not only distorted the meaning of Islamic economics but has also marginalized some of the most important and even constitutive elements of Islamic economics, such as justice and poverty elimination. The paper raises the question, “Why is Islamic economics not just economics?” After explaining why discussions of justice are marginal to the current discourse on Islamic economics, the paper identifies several questions, which expose the interests that underpin the dominant understanding of Islamic economics. It is argued that the ideas of justice in the economic arena, consultative decision-making, and sensitivity to income disparities are equally crucial for an economy to be “@alāl.” The prohibition of interest may be a necessary condition, but it is certainly not a sufficient condition, for an economy to qualify as Islamic.

## I. INTRODUCTION

This paper seeks to identify the missing dimensions of Islamic economics and the Islamic dimensions of East Asian economies. While there is much talk about Islamic economics, there is no Islamic economy, which implies that all theorization about Islamic economics is more like wishful thinking than based on practical analysis. Moreover, for reasons that have not been explored systematically but are intuitively discernable, Islamic economics has become synonymous with interest-free banking. Many other important elements of Islamic economics are completely ignored or even suppressed. Perhaps this may be a reason that Islamic economies have not really materialized. Finally, this paper intends to demonstrate how East Asian economies have institutionalized Islamic principles in contemporary economic practices and are harvesting great benefits. The blinders that prohibit most Islamic economists from looking at anything other than interest-free practices has precluded them from even recognizing the existing Islamic practices in “other economies.”

## II. THE MYTHOLOGY OF ISLAMIC ECONOMICS

The only aspect of the so-called “Islamic economics” that has enjoyed limited application, is “interest-free banking.” The limited amount of empirical work one encounters in Islamic economics is confined to discussing and fine tuning the problems and extant solutions (*like murāba@a*) of commercial lending without the institution becoming a full partner or a pure lender. The former would discourage deposits and the latter is forbidden. For some mysterious reason, Islamic economists have chosen to make absence of interest as the defining characteristic of an Islamic economy. While usury/*ribā* is indeed forbidden, the widespread assumption that the absence of *ribā*/interest is necessary in an economy for it to qualify as Islamic is puzzling.

In spite of the growing agreement that interest is *ribā*, I believe that there is more to *ribā* than interest. When we describe *ribā* as interest we do injustice to it *by limiting it*. In a way, all kinds of “excesses” constitute *ribā/isrāf*. Even if we accept that *ribā* and interest are similar, why should it be necessarily absent from an economy. *Ribā* is forbidden for Muslims, not for non-Muslims, and non-Muslims are not banished from Islamic economies, are they? Even in the Prophet’s Medina, *ribā* was in vogue. Muslims were forbidden from taking or giving *ribā*, but non-Muslims, who under the Medinan covenant were allowed to practice their own *sharʿa* (@*alaqa*), freely gave and took *ribā*. These same usurers also bought and sold goods in the same market places as the *Āa@a*. The Medinan economy was therefore not an Islamic economy if the absence of interest/usury/*ribā* is made a litmus test for defining an economy as Islamic.

The answer to the puzzle, why Islamic economics is reduced to Islamic banking can be gleaned from two contemporary conditions. First that absence of an Islamic political economy and second the lack of autonomous

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markets/economies. The first is easy to understand. In many parts of the Muslim world the existing political structures are not specifically geared toward realizing an Islamic society. Many of the legal codes have been borrowed/imported wholesale from colonial regimes. Not only are the polities based on non-Islamic jurisprudence, but also the program of liberalization of Muslim economies, often dictated by the IMF and World Bank or conditional foreign aid, is based on assumptions far from Islamic in their origins. Foreign norms and new economic policies serving the interests of globalization rather than Islamization undermine the prospects of Islamic political economies taking root in the Muslim world.

The global economy has increasingly become interdependent. The complex network of exchanges of raw material, intermediate goods, finished products, capital, labor and technology, in addition to the multi-layered ownership of the modes of production across borders generating multiple forms of traffic in goods—inter-industry, intra-industry, inter-firm and intra-firm, has made it impossible for any society to carve out an autonomous economic arena where “local norms” can be implemented or enforced. Moreover, the global norms that shape the character of the global economy are dictated by the most powerful players in the system—U.S., Japan and EU. Even though Muslim societies are not as deeply embedded in the interdependent dimension of the global economy (except for the biggest oil exporters), they remain highly dependent on the global economy. Interdependence undermines autonomy and limits the scope for Islamization of economies.

This double jeopardy precludes the development of an Islamic political economy and reduces the role of Islamic principles in the economic arena. While global governance and interdependence prevent the Islamization of economies, they have little bearing on the discussion of economics generated by Muslims. Thus, one sees the rapid Islamization of economics without any concomitant effect in the practical arena. The growth of oil-generated surpluses in some Muslim countries has allowed some degrees of freedom in the banking industry and thus the advances in Islamic economics have translated into limited Islamic banking practices.

While it is easy to understand the conditions that limit the realization of an Islamic economy, namely the absence of an Islamic political economy and the lack of autonomy, the limits on the discussion are difficult to comprehend. Why has *ribā* alone taken center stage? Why are other aspects of Islamic economy, such as *‘adl* (justice), *zakāt* (distributive justice), *isrāf* (prohibition of extravagance), *falāh* (welfare), ignored or marginalized? Why have not issues such as equality of opportunity, public welfare, frugality, charity, just wages, compulsory education, transparency in fiscal policies, *i‘tisāb* commissions on *isrāf*, discrimination in the work place, poverty alleviation, redistribution of wealth, attracted the attention of scholars seeking to Islamize economics? There is no evidence either in the Qur’an or the Prophet’s (peace be upon him) traditions that suggest a hierarchy of Islamic economic values. There is no evidence that *ribā* is worse than *isrāf* or that instituting *‘adl* is less important than prohibiting *ribā*? We do know that the Qur’an places social justice as the second most important value after individual virtue (5:8). So why are we ignoring the issue of justice? Why is Islamic economics not synonymous with “just economics” and not just interest-free banking?

While we are in this critical mood, let us explore some more fundamental aspects of Islamic economics. Can we have an Islamic economy without first realizing an Islamic polity? Is Islamic economy autonomous of Islamic governance? Can we have Islamic economic practices while the rest of the society is living according to the Swiss or the French legal codes? What is an Islamic economy? Is it a set of norms or the practices of Muslims? Is it necessary that those who claim to practice Islamic economics should necessarily be Muslims? What is the purpose of Islamic economic principles? Are they given by God as a test of the believer’s commitment to Islam, meaning that they add to the cost of economic transaction and undermine the efficiency of the economy? Or are they principles that enhance the capacity of the economy to fulfill the aspirations of the people and actually contribute to development?

The subsequent section shall seek to demonstrate that many of the Islamic economic principles so blatantly ignored in the Muslim world are widely practiced by and have given benefit to other societies. In particular, by the East Asian economies, whose performance in the last three decades has earned extensive admiration and has been labeled as “the East Asian Miracle.”

### III. THE THEOLOGY OF EAST ASIAN ECONOMIES

This section will explore some of the more widely circulated explanations for the East Asian economic miracle. In doing so, it will identify three important ingredients of the miracle—high savings, consultative decision-making and more even distribution of wealth—which are the elements one should find in the hypothesized Islamic economy. While Muslim economists marginalize these Islamic criteria, non-Muslims assiduously adhere to them and benefit from their virtues.

The phenomenal development and growth sustained by East Asian economies for over three decades has attracted the attention of scholars from developed and developing nations alike. Developing countries have sought to emulate these countries in order to achieve their growth patterns, while Western nations study these economies with fear and uncertainty as it is becoming increasingly clear that East Asia will eclipse the West in the economic arena. Already Japan, the world's second largest economy, has exceeded all Western countries, in particular the U.S., when it comes to indicators of wealth and prosperity such as balance of trade, per capita income, life expectancy, and current reserves.

**TABLE 1. VITAL STATISTICS FOR LEADING ECONOMIES**

<b>Country</b>	<b>GNP (\$ billion)</b>	<b>Rank</b>	<b>GNP/head (\$)</b>	<b>Life Expectancy (Male/Female)</b>	<b>Current Account Balance (\$ billion)</b>	<b>Foreign Exchange Reserves (\$ billion)</b>
Japan	4,772	2	37,850	77/83	65.884	227.018
USA	7,690	1	28,740	74/80	-148.726	134.880
Germany	2,320	3	28,260	73/80	-13.072	105.208
France	1,526	4	26,050	74/82	20.561	54.651
UK	1,220	5	20,710	74/80	-2.889	37.636

Source: World Bank Report on World Development, 1998/1999

Western scholars, particularly after the end of the Cold War with Western priorities shifting from security concerns to economic concerns, have pondered the miraculous development of East Asia and its implications for global economy and the balance of economic power. Many explanations have been advanced. Some superficial and some profound. Regardless of the character or the nature of the narrative, all agree that the outstanding feature has been the *sustained nature* of East Asian growth. It is not the wealth of these societies that is the issue here, it is their ability to identify and institutionalize policies that consistently bring extraordinarily high growth rates, sometimes even in double digits, that is remarkable.<sup>1</sup>

For analytical purposes the East Asian region is usually divided into five sub-regions. The first area is Japan, which is distinct from the rest of the region. The second sub-region consists of South Korea, Taiwan, Hong Kong and Singapore, the Asian Tigers and the NIEs (Newly Industrialized Economies). The third region includes Malaysia, Indonesia, and Thailand. The fourth region is China, and the fifth includes North Korea and Philippines.

Japan remains Asia's only nation to have industrialized in the nineteenth century and it actually lagged only four decades behind the English industrial revolution. Japan has grown in a fashion similar to the West. It too shifted from agriculture to industry in the late nineteenth century, went on an imperial binge, and colonized China and Korea and much of the region. It was a principal player in the Second World War and in spite of the devastation in that war, grew courtesy of the Korean War. China is a world by itself. It has joined the Asian economic march late but is rapidly growing economically. North Korea and Philippines are remarkable only for their failure to benefit from the overall growth in the region. Malaysia, Indonesia, and Thailand have enjoyed high growths like the NIEs but unlike the NIEs, much of it comes from an initial reliance on natural resources. No doubt they are growing rapidly, but they are not as advanced or as prosperous as the NIEs. Our focus in this essay is on the NIEs, which includes South Korea, Taiwan, Hong Kong, and Singapore.

TABLE 2. GROWTH RATES IN EAST ASIA

Country	Growth Rate, 1955–1970	Growth Rate, 1965–1980	Growth Rate, 1980–1993	Current GNP/head (\$)
South Korea	6.7%	9.9%	9.7%	10,550
Hong Kong	9.6%	8.6%	7.1%	25,280
Singapore	—	10.0%	6.4%	32,940
Taiwan	8.7%	8.9%	8.8%	12,400
Malaysia	5.3%	7.4%	5.2%	4,680
Indonesia	3.6%	7.0%	5.5%	1,110
Thailand	6.9%	7.3%	7.6%	2,800
China	—	6.8%	9.5%	860

Source: World Bank Report on World Development, various years.

There are many theories that seek to explain the performance of East Asia's NIEs. The simplest explanation and the one preferred by East Asians is the political culture argument. This argument suggests that there is something inherent to Confucian values, such as respect for order and harmony, that has facilitated this Asian miracle—development and prosperity without the negative aspects of modernity, declining moral values, disintegration of the family structure and growth of crime and drugs, which have plagued Western societies. Indeed, the amazing growth of societies with little or no natural resources, Hong Kong, Singapore, South Korea and Taiwan, is largely due to the diligence, ingenuity and handwork of their human resources, who have one thing in common—the Confucian way.<sup>ii</sup> Other societies in the region like Indonesia and Malaysia where Islam dominates, natural resources have played as much a role in development as have human resources. For example oil for Indonesia and tin and rubber for Malaysia. But even in these places, it is the Chinese who have dominated industrialization and most of the investments and technology has come from Chinese conglomerates.

However, there are many flaws in this theory. If Confucian values are singularly responsible for the East Asian growth, then why did not these values provide growth earlier and only after the 1960s? More importantly, why have not these values vitalized other societies that adhere to the same principles? One may argue that once development took place, Asian values protected these newly modernized societies from plunging into moral decline like some Western societies. But that idea remains a thesis that has not been subject to serious exploration. Nonetheless, the theory of Asian/Confucian values provides Asian leaders with great fodder for their after-dinner speeches in foreign capitals but nothing more.

The political economic explanation of the region's growth may offer more important clues for understanding it. According to this perspective, the two most important elements of the growth has been the role of a benign and authoritarian state that has single-mindedly pursued economic growth, and the role of the U.S., which has provided security guarantees, foreign and development aid, open and unfettered access to American markets without any reciprocal gesture and the continued flow of technology from both Japan and the U.S.<sup>iii</sup> The U.S. has invested over \$20 billion dollars in foreign aid into the region, subsidized defense and provided necessary infra structural support for establishing capitalist economies East Asia. Currently the East Asian tigers run positive balance of trade of about \$55 billion per year with the U.S.<sup>iv</sup> The prosperity of Japan has also assisted the region, as it has increasingly become a "Japanese zone of co-prosperity." Fear of NAFTA and the EU has also driven Japan

toward providing more financial support, through FDI (Foreign Direct Investments), ODA (Official Development Aid), Consumer lending and lending through multilateral institutions like Asian Development Bank whose primary sponsors are Japan and the U.S. Japan is also opening up its markets for East Asian products by exporting them intermediate goods and important finished goods. But Japan runs a positive trade balance with East Asia and the American market makes up the deficit.<sup>v</sup> Thus in many ways the East Asian miracle is dependent on American and Japanese markets, investments and technology transfers, besides American security guarantees and open-market policy even in the face of heavy trade barriers to American goods in the same countries.

The International Political Economy (IPE approach) of Strange et. al does shed light on my many aspects of the development phenomenon, technology, resources markets, but there are some elements of the process, such as savings rate and frugality, consultative decision-making and equitable distribution of wealth, which cannot be explained through IPE models. These are the elements that are not only crucial for understanding East Asian growth but are also, in my opinion, elements of an Islamic economy. Perhaps these are qualities that the Asian people hold in common due to their common Confucian heritage. But they are found not only in the Chinese dominated East Asian countries but also in Japan, and in Malaysia and Indonesia, which are predominantly Muslim societies. It is widely accepted that these three elements have played a key function in the East Asian miracle. It is submitted that these same elements constitute the key elements of an Islamic economy.

#### IV. ISLAMIC ECONOMIC PRINCIPLES

##### A. Avoiding *Isrāf*

In verses 17:27 and 7:31, The Qur'an condemns *isrāf* or wasteful expenditure. Some Islamic economists too recognize the prohibition of *isrāf* or the sanction against wasteful expenditure/consumerism as an important principle of Islamic economics.<sup>vi</sup> Elsewhere I too have recognized it as a founding principle of Islamic political economy.<sup>vii</sup> While richer Muslim societies in the past and the present are outstanding for their grandiose consumption patterns, East Asian economies on the other hand are remarkable for the high savings rates of 30-40% of GDP that they have maintained for nearly four decades.<sup>viii</sup> These savings rate play a major role in the miracle of East Asia.

High savings have enabled these societies to finance their own growth, expansion, and development and avoid the foreign aid trap that has been the bane of many underdeveloped countries. Many countries in the hope of sparking growth have borrowed heavily from foreign countries and multilateral institutions. The debt burden and sometimes just the cost of servicing these debts have crippled many economies. But East Asians, thanks to their high savings, sometimes even forced as in Singapore, have managed to finance much of their capital need. Indeed the enormous capital accumulation that has resulted from these savings has made East Asian economies capable of making FDI in the U.S. and China. East Asia has shown that avoiding *isrāf*, something that Islamic economists have only talked about as a minor addendum to interest-free banking, can play a significant role in economic growth and autonomous development.

##### B. Consultative Governance

An important principle of Islamic social organization is the principle of *shūra* or consultative decision-making. The Qur'an advises Muslims to conduct their affairs through a process of mutual consultation (3:159). The Qur'an also considers them as blessed those who conduct their affairs through mutual consultation (42:38). The contemporary discussions among Islamists, Western scholars of Islam, and many Muslim intellectuals about the form democracy would take within an Islamic ethos, centers around the concept of *shūra*.<sup>ix</sup> While there is little clarity on how an Islamic democracy or "shurocracy" would look like, there is widespread agreement that *shūra* or consultation is not just desirable but a necessary ingredient of Islamic governance. Given the centrality of consultation to management of Islamic affairs, it is remarkable how little attention Islamic economics/economists pay to *shūra* and its role in Islamic economics.

East Asia now manifests some transition to democracy in Taiwan and South Korean. During the miracle years they were either single party authoritarian regimes or military dictatorships. But nevertheless these places demonstrated a remarkable degree of state-society interface and many of the policies advocated by the government were those desired by the economic sector. The social policies too reflected the popular will and therefore these states had little problem in implementing effective policies over decades. The confidence that they were able to generate in the society was because they were able to understand and pursue the goals of the society at large and therefore the policy outcomes were more consultative than authoritative. In an interesting fashion these East Asian states were ruling with both consent and through cooperation of the ruled without actually creating any Western style democratic institutions.<sup>x</sup>

The governments created consultative bodies, called advisory committees, which were composed of leaders from the society and from the state (bureaucrats and politicians). The governments also facilitated the development of associations and chambers of commerce, which became their partners in collecting industry information, and devising development strategies that would optimize the joint resources of the public as well as the private sector. These consultative bodies (which, ironically, is exactly what they are called) created multiple levels of interface between the rulers and the ruled, in many ways “tying the hands of the rulers.” The governments always sought to build consensus in order to facilitate a harmonious society.<sup>xi</sup> These interfaces helped legitimize the rulers as well as enabled the ruled to systematically give their input to policy making. Trust and cooperation emerged and state and society became partners in the pursuit of economic development and social welfare.<sup>xii</sup> Henry Rowen in his “Overview” uses a headline to describe this phenomenon in Qur’anic terms.<sup>xiii</sup> He calls it: “Understanding good and avoiding or abandoning bad policies” resonating the Qur’anic injunction: “Enjoin what is good and forbid what is wrong.” (31:17)

Consultative governance, or *shūra*, has clearly played a significant role in the miraculous development of East Asian economies. What is striking about this is that East Asian societies have discovered the merits of Islamic decision-making, through possibly a trial and error method, or from within the Confucian tradition, and have demonstrated its merit.

### C. Distributive Justice

While there are only seven verses in The Qur’an that prohibit interest (2:275, 2:276, 2:278, 2:279, 3:130, 4:161, 30:39), there are 60 verses that stipulate, mandate, encourage charity, discuss its virtues and rewards, warn of punishment to those who eschew charity and also warn against hoarding (9:34, 2:261, 2:265, 2:276, 2:280, 30:39, 34:39, 35:29, 57:11, 57:18, 64:17, 2:271, 2:245, 5:12, 57:11, 57:18, 64:17, 73:20, 2:273, 2:83, 19:31, 19:55, 9:91, 17:29, 2:3, 2:43, 2:110, 2:177, 2:195, 2:254, 2:267, 2:227, 5:55, 9:71, 13:22, 14:31, 21:73, 22:41, 22:78, 24:37, 24:55, 24:56, 27:3, 30:38, 31:4, 33:33, 47:38, 57:7, 57:10, 58:12, 58:13, 63:10, 64:16, 2:264, 2:266, 16:75, 4:38, 2:3, 3:180, 2:215). It is astounding how Islamic economists have overlooked the significance of charity, welfare, redistribution of wealth and prevention of income inequalities and wealth disparities. If anything, the sheer weight of Allah’s interest in charity and distributive justice should have made Islamic economics synonymous with “charitable/welfare/distributively-just economics” rather than interest-free banking. Islamic economists have made charity a personal issue, a desirable element of piety but not a necessary element of economy. They study *zakāt* under taxation and not as an organizing principle of society. Of course there are exceptions like Umer Chapra and M.A. Mannan. Chapra actually states the importance of distributive justice eloquently.<sup>xiv</sup> He argues:

“Hence Islam not only requires the fulfillment of everyone’s needs, primarily through a respectable source of earning, but also emphasizes an equitable distribution of income and wealth so that, in the words of the Qur’an ‘wealth does not circulate only among your rich’ (59:7).”<sup>xv</sup>

Fortunately for East Asia, their economists, unlike contemporary Islamic economists, did not give the short end of the stick to issues of income and wealth equality. Distributive justice has remained an integral aspect of the region's development. From the earliest phase of its development, East Asia has opted for “growth with equality” or “shared growth.” Nearly the entire population of each of these countries has benefited from the regional growth. Indeed Indonesia’s struggle against poverty, 60% of the population below poverty levels in 1970 to only 14% in 1993 is symptomatic of the region's success in not only eliminating poverty but also providing a higher lifestyle for a majority of its population. From 1965 till now all the countries that have combined high growth with high-income equality are in East Asia. Distributive justice, while being a worthwhile goal in itself also has many social and political benefits. It leads to widespread literacy, human development and reduces tensions between different groups and reduces the possibilities of political unrest and crime. The prosperity and relative internal peace enjoyed by East Asia is a handsome testimony to the virtues of distributive justice.

## V. CONCLUSION

The purpose of this essay is to offer a critique of the discourse on Islamic economics with the twin purposes of showing how its obsession with interest is marginalizing other important elements of Islamic economics such as justice, distributive justice and consultative decision-making, and how other economies are thriving by paying attention to these very principles. We hope that in the future Islamic economics will pay greater attention to issues of poverty alleviation, justice, redistribution of wealth and resources, and Islamic forms of governance. More importantly, it is hoped that Islamic economists will stop attempting to produce a hypothetical system in theory that

will meet their “Islamic criteria,” but rather work toward the economic development and betterment of Muslim societies in real life.

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- <sup>i</sup> Pei, Minxin. "Constructing the Political Foundations of an Economic Miracle" in Rowen, H.S. (ed.). Behind East Asian Growth: The Political and Social Foundations of Prosperity. London: Routledge, 1998. pp. 39-60.
- <sup>ii</sup> Jones, David Martin. Political Development in Pacific Asia. London: Polity Press, 1977. pp. 5-57.
- <sup>iii</sup> Refer to the essays in Ross, Robert S. (ed.). East Asia in Transition: Toward a New Regional Order. Boston: M.E. Sharpe, 1995.
- <sup>iv</sup> See Mochizuki, Mike M. "Japan as an Asia-Pacific Power"; and Zagoria, Donald S. "The United States and the Asia-Pacific Region in the Post-Cold War Era" in Ross (ed.), *supra*.
- <sup>v</sup> See the essays by Raphael, James H. and Thomas P. Rohlen. "How Many Models of Japanese Growth Do We Want or Need?"; and Kosai, Yutaka and Fumihide Takeuchi. "Japan's Influence on the East Asian Economies" in Rowen (ed.), *supra*.
- <sup>vi</sup> Siddiqi, M. Nejatullah. "Muslim Economic Thinking: A Survey of Contemporary Literature" in Ahmad, Khurshid (ed.). Studies in Islamic Economics. Leicester: Islamic Foundation, 1980. p. 196.
- <sup>vii</sup> Khan, M.A. Muqtedar. "The Philosophical Foundations of Islamic Political Economy." American Journal of Islamic Social Sciences 13(3) (Fall 1999). pp. 389-400.
- <sup>viii</sup> Rowen, Henry S. "The Political and Social Foundations of the Rise of East Asia: An Overview" in Rowen (ed.), *supra*.
- <sup>ix</sup> Esposito, John and John Voll. Islam and Democracy. Oxford: Oxford University Press, 1996. p. 27.
- <sup>x</sup> Root, Henry L. "Distinctive Institutions in the Rise of Industrial Asia" in Rowen (ed.), *supra*. Pei, Minxin. "Constructing the Political Foundations of an Economic Miracle" in Rowen (ed.), *supra*.
- <sup>xi</sup> Jones, *supra*. pp. 55-57.
- <sup>xii</sup> Root, *supra*.
- <sup>xiii</sup> Rowen. "An Overview." *supra*. p. 18.
- <sup>xiv</sup> Chapra, M. Umer. Islam and the Economic Challenge. London and Virginia: Islamic Foundation and the International Institute of Islamic Thought, 1995. Mannan, M.A. Economic Development and Social Peace in Islam. London: TaHa Publishers, 1989.
- <sup>xv</sup> Chapra, *supra*. p. 212.