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Macroeconomics in Islamic Economy: A Theoretical Perspective*

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***Sub-Theme: Macroeconomics in the Islamic Economics Perspective**

Agenda

1. Contours of an Islamic economy
2. Nature and role of government that plans and implements macroeconomic policies
3. Principal macroeconomic aggregates (target variables)
4. Macroeconomic data
5. Macroeconomic set-up, policy framework and goals
6. Monetary policy
7. Fiscal policy (while taking into account institution of zakah)
8. Labor policy
9. Exchange rate policy
10. Maqasid-e-Shari'ah and macroeconomic policy
11. Relevance in the current times

Distinguishing Characteristics of An Islamic Economy

- Terms of Reference: The Qur'an and the Sunnah
- Supremacy of the Shari'ah
- Equality of Man
- 'Adl (justice)
- Emphasis on economic efficiency as well as distributional equity

Contours of an Islamic Economy

- “An” Islamic economy – No such thing as “the” Islamic economy
- Individualism – Everyone comes to the world alone, shall go back alone and be accountable, in the Hereafter, alone (*see also below*).
- Socially responsible individuals linked with one another through family bonds, the Shari’ah-based rights–obligations structures and permissible forms of transactions
- Market-based economy with a unique transactions matrix and the associated institutional set-up
- Financial intermediation/transactions in Shari’ah-based ways whereby financial institutions act as economic agents, and financial and real sectors of the economy are closely integrated.
- Government (*see next*)

Government and Its Role in the light of the Shari'ah Principles

- In the end those at the helms of the government — the rulers — are individuals whose occupation carries special rights and obligations as well as entitlement to special privileges and rewards in this world and in the hereafter.
- There is “Shari’ah” for the rulers in the same way as it is for the common man. — Original Ahkam of the Shari’ah are given at the micro level for simple cases in a do/don’t form. Some generalizations are needed for fiqh for government.
- Government has dual character:
 - 1) Representative of the Shair’ah in the domain of the rights and obligations of the individuals vis-à-vis the Shari’ah (Wali al-Amr)
 - 2) Representative of the people in their collective matters
- All prohibitions of the Shari’ah (e.g., no riba) automatically apply to the government. The same may not always be true for the permissibilities.
- Government ought to protect interests of the individuals, both in this world and in the hereafter.
- Government must maintain a neutral stance among its subjects, and not favor one over another without the latter’s free willing consent.

Government (contd.)

- Government's role: Facilitator–cum–adjudicator in economic affairs of the people without breaking any Shari'ah rule.
- No direct participation in economic activity – A question mark on public sector economic enterprises
- No riba-based transactions by or on behalf of the government
- Hands-off , in favor of the private initiative, from all charitable and welfare–oriented activity except the zakah matters
- Principal responsibilities of the government:
 1. Provision of institutional framework for private initiative within the limits of the Shari'ah
 2. Provision of pure public goods (like deterrent for external foes), justice and law and order
- For all non-pure public goods, the government may temporarily come into the picture in order to fill in the gap(s).
- A likely role of government: human resource development on behalf of the citizenry

Scope of Islamic Macroeconomics

1. Working and performance of an Islamic economy on not only economic but also the Shari'ah planes
2. Macroeconomic policy in an Islamic economy
3. Macroeconomic analysis in the context of non-Islamic settings with the aim of identifying macroeconomic policy for their Islamization
4. Comparison of performance of an Islamic economy with other economies with similar resource endowments but non-Islamic architecture

Principal Macroeconomic Aggregates (Target Variables)

- Aggregate output and income
- Price level
- Employment level — Entrepreneurship/Self-employment might be subsumed here
- Variables related to Islamic financing modes
- Poverty and income inequality
- Inflation (Secondary concern for an Islamic economy due to the integration of the real and the monetary sectors)
- Exchange Rate
- No separate focus might be necessary on “Growth with Stability” and “Growth with Equity” because such concerns are accommodated in the Islamic architecture of economy.

Macroeconomic Data: National Income & Expenditure Accounts

- Measure of economic activity: GDP or GNP
—Measurement through expenditure (value at market prices) or income (factor cost) method
- Other Aggregates: NDP, NNP, NI, Personal Income, Personal Disposable Income and their distributions among the people
- Measures of Poverty, Disparity and Inequality (in the distributions of personal income, personal disposable Income and wealth)
- Wealth and its distribution in the economy
- Zakah — Both collection and disbursement

Other Macro Data

- Employment
- Entrepreneurship (Self-employment)
- Realized rate of profit — overall as well as in various economic sectors
- Margins in murabahah financing and rental in ijarah financing
- Relation between profits and profit-sharing ratio — overall as well as in different sectors
- Indebtedness at micro and macro levels

Macroeconomic Set-up of an Islamic Economy – 1

- Goods Market— The economy may be perceived as a mega goods market with producers on the supply side and the public (consumers — both the haves and the have-nots), investors (another acronym for ‘producers’) and government on the demand side.
- Financial Side:
 - (1) Source of Outside Money: Government/Central Bank
 - (2) Financial Assets: Money, Mudarabah Deposits, Islamic Securities, Islamic Stocks
 - (3) Financing Modes: Murabahah, Salam, Ijarah and Musharakah
- Labor Market
- Institution of Zakah (mainstay of the welfare agenda)

Macroeconomic Set-up – 2

The Institution of Zakah:

- Government to be the sole body for assessment, collection and disbursement of zakah
- On the collection side, extensive setup needs to be in place for covering the economy across:
 - (1) population (rural, urban, mining and nomads),
 - (2) economic zones (agricultural, minerals, industrial and commercial), with due margin for the type of economic activity at the micro level in each zone
 - (3) Institutionalized economic activity (personally and publically owned businesses)
 - (4) Financial institutions
- On the disbursement side: Zoning of the economy according to poverty and other important factors whereby zakah can be utilized, according to a well-developed criteria.

Framework for Macroeconomic Policy

- Islamic Economy
 - Analysis for non-Islamic economy also to be carried out against this backdrop
- Zakah (for distributional concerns)
 - Institutional framework for assessment, collection, preservation and disbursement of zakah—Economic topography
- Islamic monetary framework
- Where the one or all of the above are missing, conclusions are to be drawn with due allowance for departures from the respective Islamic economic norm.

Goals of Macroeconomic Policy in Islamic Economics

- Fulfillment of fundamental economic rights — minimums of food, clothing & shelter and inheritance rights — of the people
- Preservation of the Islamic character of an Islamic economy or Islamisation of the economy in other cases
- Keeping the economy afloat and facilitating its growth through non-fiscal measures except in an emergency situation
- Achievement of the necessary deterrent, without the avoidable paraphernalia

Goals of Macroeconomic Policy – Some Further Considerations

- The goal of reduction in economic disparity and inequality to be addressed largely through the institution of zakah and regulatory measures at the government level. — Activist fiscal policy may be pursued to reduce inter-regional economic disparities in the interest of unity of the state.
- Direct market intervention to promote unemployment, control inflation, etc., is not a policy agenda, especially activist fiscal policy involving current or future taxation for doing the needful.
- Monetary policy action to influence murabahah-financing margins, etc., may work through manipulation of high-powered/outside money and the velocity of its circulation.

Monetary Policy

- Monetary policy is to work in tandem with the fiscal policy with the Shari'ah considerations providing justification for fiscal action by the government.— Technically speaking, central bank would be just an organ of the state like the government (ministry of finance or public treasury): no independent central bank.
- Difference to be maintained between (1) the process of generating claims, i.e. transactions at the micro level, and (2) facilitation of the said claims in a highly efficient manner
- Focus of monetary policy to be on quantity of outside money through fiscal channels— with efficient Islamic bank, inter-bank market and other financial markets streamlining the flow of money to accommodate the transaction needs in the economy
- The last point also covers targeting of the velocity of outside money.

Fiscal Policy

- The welfare side to be left to state-managed zakah institution and private initiative — The Islamic approach to poverty is basically grassroots approach with both the initiative and necessary action taken at the micro level.
- Scope for fiscal action (through the government budget) is likely to be limited to:
 - Fulfillment of fundamental economic rights (in case of systemic failures)
 - Development of economic infrastructure at the micro level (safe-drinking water, streets, etc., local roads and other means for transportation), national level infrastructure (highways, bridges, dams, etc.) and human resource development
 - Maintenance of a credible deterrent
- Narrow space for public works programs for doing the needful
- Review of existing fiscal action for tuning of the economy

Labor Policy

- Significance: Wage-based/salaried employment is the largest source of income in virtually all modern economies.
- Availability of opportunity for employment would be better with the integration of real and financial sectors in the economy.
- Government is not expected to directly participate in economic activity due to the existence of the Shari'ah-constraints. At the government level, scope for employment generation would be limited.
- Focus on human resource development holds the key to solve labor market problems. Education and training may increase mobility of labor and, thereby, lessen structural employment problems
- Due to the Shari'ah requirements for wage contracts and the long-term nature of employer-employee relations, the regulatory role for government will become more important

Exchange Rate Policy

- No foreign exchange controls — exporters to be free to hold on to their export earning, importers to be on their own to meet their foreign exchange needs, investors operating freely in the foreign exchange market and government meeting its foreign exchange needs through taxation — taxation of exports and imports in foreign currency, acquiring foreign exchange with local currency resources at the expense of the government
- Government should keep a distance from the fiscal action that may adversely affect the foreign exchange markets.
- In principle, no direct intervention in the foreign exchange market at the government/central bank level

Maqasid al-Shari'ah and Macroeconomics of an Islamic Economy

- Maqasid al-Shari'ah are originally conceived in terms of protection of five things:

Religion (*Deen*), Life (*Nafs*), Progeny (*Nasl*)

Intellect (*'Aql*) and Property (*Maal*)

- Promotion of the above Maqasid is the ultimate goal of macroeconomic policy.
- The goals of various policies, spelled out earlier, work toward the fulfillment of the Maqasid.
- Focus on human resource development, along with enforcement of the Shari'ah, holds the key to the achievement of the Maqasid at the macro level.

Relevance for the Current Age

- The Shari'ah is a way of doing things. It means accommodation of the Will of Allah SWT – the Original, the Absolute and the Ultimate Owner of every thing that is in the heavens and the earth.
- That Allah SWT is infinitely Kind to man, is sufficient to believe that all the prescriptions of the Shari'ah are in favor of the mankind.
- Islamic economics prescriptions help to (1) remove the dichotomy between the real and the financial sectors in an economy, (2) curtail the excessive demands on the government and (3) provide the basis for long-term growth along with narrowing the gaps between the haves and the have-nots but without inflation.

Thank you.