

## **A Review of the Transformative School in Islamic Economics**

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**ABSTRACT.** This paper analyzes some critical issues in the methodologies of Islamic and mainstream economics. It also presents an analytical account of different methodological approaches suggested in Islamic economics literature for use in building the theoretical foundations of Islamic economics. In particular, this paper reviews the transformative school as a distinctive methodological approach. It analyzes the different propositions put forward in the transformative school. It calls for a problem-solving approach and methodological pluralism by separating economic choices made with economic resources and non-economic choices also made with economic resources. The former can be analyzed in an integrative framework after certain required modifications. The latter shall not be studied under the mainstream tools since the mainstream analytical tools are not suitable and capable of analyzing such choices. Inductive and empirical studies can be carried out with statistical and econometric tools where they are appropriate without having ideological constraints. It is argued that *homo-Islamicus* is not required to adopt monasticism. *Homo-Islamicus* is a human being who desires to live within the norms and rules of his faith. However, he has economic as well as spiritual needs.

**KEYWORDS:** Islamic economics, Neoclassical economics, Behavioral economics, Methodology of economics, Utility maximization, Profit maximization.

**JEL CLASSIFICATION:** A23, B41, D63

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### 1. Issues in the Methodology of Mainstream and Islamic Economics

Mainstream economics focuses on analyzing the behavior of consumers and firms in the market and the impact of choices on market outcomes. Since the second half of the twentieth century, there is increased use of mathematics in analysis on the premise that it can aid in the analysis of reality where several factors are simultaneously at play. For mathematical tractability, the focus is placed on such factors which are readily measurable so that empirical evidence can incorporate such factors.

It is assumed that the role of culture, customs, norms, and values would not be possible to include directly and endogenously in mathematical analysis and that such factors can be put aside as far as economic analysis is concerned. Such unobservable factors would shape preferences and hence choices. But, if choices can be analyzed, then indirectly, the influence of such unobservable factors would still be incorporated through their effects on choices. However, due to the problems of measurement and for ensuring mathematical tractability, such factors themselves cannot be endogenized in the mathematical models.

It is argued by Friedman (1953, p. 7) that heroic assumptions should not be the reason for abandoning confidence in economic models. The most complex model is reality itself. But, we cannot systematically understand the partial and unique contribution of different factors that are simultaneously changing in a dynamic context. Mainstream economists argue that all models are false. But, some are useful. Usefulness is expected in terms of the predictive power of the models. If a model has some unrealistic assumptions but can help in prediction, then it is useful for the purpose for which it was constructed.

On the other hand, Muslim economists working in Islamic economics literature, by and large, do not think that these assumptions are innocuous. They take them seriously and compare them against the Islamic precepts and worldview. For a mainstream economist, formulating the objective function is an attempt to make a model that can help in predicting market outcomes. But, upon reading terms, such as 'goal', 'objective' and 'choice bundles' available to agents, many of the Muslim economists tend to compare them against the 'ultimate goal' and 'ultimate

objective' in the Islamic worldview. For instance, Khaleel and Avdukić (2020) explain that consequential moral reasoning concentrates on the consequences of an act. Bentham (1890) adopted consequential moral reasoning in developing the concept of utilitarianism. The concept of utility has its roots in the idea of pain and pleasure. In contrast, Islam has its theme for pain and pleasure, which originates from the paradox of *ma'rūf*<sup>(1)</sup> (known good), and *munkar* (known evil).

Many Muslim economists think that there is an incompatibility between the worldview of Islam and the axioms on which the foundations of mathematical analysis in mainstream economics are built. Mahyudi and Abdul Aziz (2017, p. 238) contend that *homo-economicus* is driven by rationality while *homo-Islamicus* is driven by *taqwā* (God-consciousness). Sharing the same line of thought, Furqani (2018, p. 1) thinks that mainstream economics is developed from the foundations of the secular worldview which is characterized as a materialist (excluding the metaphysics), reductionist (reducing based on a positivist epistemology with atomistic perspective), and individualist (isolating individual from society).

All is not well with mainstream economics, especially in macroeconomics as highlighted by Nobel laureates like Robert Solow, Joseph Stiglitz, Paul Krugman, and Paul Romer among others. Mahomedy (2016b, p. 3) thinks that economics eventually became alienated from the reality that it was purported to explain.

However, all is not well in Islamic economics too. Azizy (2019) thinks that both *homo-economicus* and *homo-Islamicus* based theories of the economic agent are unrealistic and there is a need for realism. The ethically focused *homo-Islamicus*, like its neoclassical counterpart of *homo-economicus*, turned out to be a fiction that has no empirical counterpart (Mahomedy, 2016a, p. 35). Mahyudi (2015, p. 63) provides a reality check exercise which reveals that Islamic economics institutions' weak social performance shows the absence of *homo-Islamicus*.

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(1) The definitions for all Arabic terms in the paper are given in the 'Glossary' in the intro pages.

Mariyani-Squire (2013, p. 1) thinks that the discipline of modern Islamic economics is currently torn in opposing directions by different visions of what its nature should be. On one hand, it is argued that modern Islamic economics is too heavily influenced by secular economic theory. On the other hand, it is argued that an overreliance on theologically-informed ideals would render Islamic economics to be unduly unrealistic.

It seems that there cannot be any co-existence and integration without one accepting the other's world-view. Is there room for methodological pluralism? Reardon (2019) shares disappointment that despite limitations in the predictive power of current models, mainstream economics is shy of methodological pluralism. Al-Afandi (2019, p. 87) thinks that there is a new bridge of communication between contemporary economics and Islamic economics, where behavioral economics had a role to play in its construction. Nienhaus (2019, p. 89) also thinks that Islamic economics may benefit from innovations in microeconomics where recent progress is made, particularly from behavioral and experimental economics and the adaptation of new tools such as simulations and network analysis.

Nonetheless, Nienhaus (2019, p. 89) also notes that since mainstream economics is not ready to accept positive knowledge by reference to scriptures, it will create hurdles in dialogue. On the other hand, Diab and Boubechiche (2018, p. 887) admit that for Muslim economists, it is not possible to prove the non-sensory knowledge found in the Qur'ān when generating Islamic economic theories.

Among the various schools which call for a distinctive methodology of Islamic economics, the transformative school of thought in the methodology of Islamic economics is not that much interested in descriptive studies and improving the predictive capability of models to analyze market outcomes and to design policies accordingly. It believes in the transformation of choices through education. Therefore, the new researches in behavioral economics are only consulted to make criticism of mainstream economics, rather than developing an alternate path for economic analysis.

Some economists working in Islamic economics take the stance that instead of engaging in philosophical and epistemological discussions, the focus should

be on solving economic and development problems which are real. Cattelan (2018, p. 2) opines that the objective of Islamic economics is to provide answers to human economic problems through solutions that are grounded in the Islamic religion. Aydin (2018, p. 21) thinks that internalizing moral axioms would serve as an ethical compass necessary to establish formal and informal institutions for efficient and ethical business organizations.

Hasan (2019) remarks that since there is no real Islamic economy on the ground following Islamic norms, we cannot go beyond building castles in the air. In this sense, he shares the aim of the transformative school, but does not wish to engage in philosophical hair-splitting discussions and merely articulating Islamic ideals as a defense. Al-Saati (2013, p. 40) admits that Muslim writers, despite criticizing conventional economic paradigms on the grounds that it contradicts the Islamic worldviews, have not been able to find alternatives to the conventional paradigms and methodologies. Khan (2014, p. 10) argues that the most glaring deficiency in the existing literature is that it restates Islamic economic teachings but does not move very far towards transforming this knowledge into a social science that would allow the verification or falsification of its postulates. Siddiqi (2014) also maintains that rather than confronting rival ideologies as was done at the beginning, Islamic economics today should be responding to the challenge of living by Islamic teachings. Hence, Hasan (2019) thinks that we should allow methodological pluralism and take a problem-solving stance in research.

## **2. Brief Account of Schools of Thoughts in Methodology of Islamic Economics**

There are many methodological approaches put forward by esteemed economists in Islamic economics. These approaches include the circular economy approach, moral economy approach, institutional approach, assimilative approach, and pure transformative approach.

The circular economy approach takes its inspiration from the recent literature on environmental sustainability. It is based on the idea that resource utilization should avoid waste and ensure recycling for sustainability. In its vision and aims, it is not a concept unique to Islamic economics. Potentially, Islamic economics can offer a set of principles and values

to engender commitment, responsibility, and moderation in using resources without excess and waste among Muslims in particular. Islamic finance also has alternate institutions to mobilize funds through financial markets via *ṣukūk* and institutions, such as Islamic banking and *waqf*.

The moral economy approach favors dualism in policy and institutional design of products and organizations whereby the moral aspect is imbued with the commercial or economic aspects. Again, it is similar in vision to social economics by laying more or equal emphasis on issues of morality, fairness and equity.

The institutional approach takes a more practical stance by developing products and structures to deliver those products through the markets. Islamic banking and financial institutions have come about by the efforts in that direction. However, many critics argue that this approach is, at best, an effort to assimilate historically evolved institutions in Muslim society without much originality and economic distinction. Aydin (2013, p. 1) explains that the more recent literature on Islamic economics is largely about Islamic financial instruments and institutions. It might give an impression that the main difference between conventional and Islamic economics is in the instruments rather than the foundational aspects.

In its methodological approach to develop and devise an operational structure of institutions, it relies on *fiqh*. This brand of literature treats Islamic economics as a branch of applied *fiqh* in economics and financial matters. The aimed and acclaimed outcome of such research is to come up with consistent rulings for Muslims to abide by Islamic Sharī'ah in economics and financial matters. It hesitates to indulge in analysis from economics and other perspectives. It also looks down upon, undermines, or ignores the analytical works and pursuits in Islamic economics beyond their aimed jurisprudential focus, unless such analyses help in defense of practical rulings or in putting forward criticism of conventional finance in particular and capitalism in general.

The assimilative approach takes the mainstream economics methodological framework and attempts to embed Islamic concepts in theoretical models through assumptions and choice variables. It is contended that utility in the Islamic framework is not just limited to hedonistic happiness as in Bentham's (1890) utilitarian framework. The Islamic concept of

*falāḥ* encompasses meaningful success in the material and spiritual sense, both in this worldly life and the hereafter. However, it has limited success in embedding Islamic precepts in the mathematical models which are conceived and designed to analyze the choice behavior of agents in markets.

The integrative approach separates economic and non-economic choices and market versus beyond market choices and resource allocation. It is not concerned about losing the opportunity of aggregation and general equilibrium analysis. It lays more emphasis on allowing room for analysis of economic behavior and its impact in determining market outcomes. This approach does not try to embed spiritual and pro-social choices in objective functions. It acknowledges that doing so will mean that such choices will give unqualified sovereignty to the agent. Therefore, resource allocation of time, wealth, and income to social causes, volunteering, and charities is deducted from the resource budget without analyzing it in the objective function that is only suited to analyzing choice behavior in markets. More details of this integrative approach will be provided in section 7 of this paper.

The 'distinctive' approach calls for a distinct methodological framework. The 'transformative' approach in the distinctive school almost disregards the need for descriptive and positive analysis and lays complete focus on transformation. For making its case, it suggests discarding all theoretical edifices of mainstream neoclassical economics and adopts a rather 'preaching style' way of transforming of behavior through Islamic-founded education. Many other authors emphasize transformation, but this school of thought focuses entirely on transformation. This school believes that transformation can create a revolutionary change as happened fourteen hundred years ago when Muslims received and followed divine knowledge and which alone made them successful in both politics and sciences.

All these approaches are neither entirely correct nor incorrect. They are also not completely mutually exclusive. What differentiates them is the difference in priority and focus. In this paper, a humble attempt is made to provide an objective and critical review of the transformative school of thought in Islamic economics. Many scholars are in broad agreement that Islamic economics cannot be just descriptive. It has

to be transformative as the message of Islam itself compels transformation of thought and practice. However, this school gives it highest priority as well as exclusive focus as the central aim of the field. The respected author of the lead paper in this discussion forum, Asad Zaman, can be regarded as the most potent voice in this school. In his lead paper, Zaman (2021) has articulated his thoughts clearly.

### 3. Analysis of Major Propositions of the Transformative School of Islamic Economics

In this section, reference is made to Asad Zaman partly because this paper is meant to respond to the lead paper and partly because for presenting the case of transformative school; the respected scholar himself did not cite other scholars in Islamic economics. There are 14 citations to his works, but there is no reference to any single author from the Islamic economics literature. Therefore, his views can be regarded as representative of the transformative school. There are many points raised by Zaman on which there is broad agreement among Muslim economists. It would not be worthwhile to repeat those points. Here, an attempt is made to discuss certain propositions where it is felt that it is important to provide another perspective.

#### **Proposition 1: Western social science based on secular worldview is entirely useless**

It is argued that Western social science was developed by Westerners, keeping Western society and historical experience in mind. Zaman (2021) writes:

Social science is the study of human societies; surely, any such study would be specific to the society, historical time, and geographical context. How can a social theory apply equally to the Inca civilization, the Mali civilization, the hordes of Genghis Khan, as well as modern Somalia, Germany, and China? (p. 84)

If this argument is taken, then what is the basis of Islamic social science using Arab experience of fourteen hundred years ago and asking for its universal application while demeaning any other social experience as useless? There is a strong imprint of Greek and Muslim civilization on the philosophy, law, and physical sciences which developed in West and such knowledge was embedded and integrated rather than completely disregarded and discarded.

Briffault (1919) writes:

What we call sciences arose in Europe as a result of a new spirit of inquiry; of new methods of investigation, of the method of experiment, observation, measurement, of the development of Mathematics in a form unknown to the Greeks. That spirit and those methods were introduced into the European world by the Arabs. (p. 191)

Campbell (2002, p. 13) writes: "In Europe, the unsettled conditions led to the discouragement of scholarship, while the Caliphs of Baghdad, on the other hand, afforded protection and encouragement to the scholars of all religions". In the same vein, Ghiles (1983, p. 359) writes: "At its peak about one thousand years ago, the Muslim world made a remarkable contribution to science, notably mathematics and medicine. Baghdad in its heyday and southern Spain built universities to which thousands flocked".

Apart from some authors like Weber (1930), this imprint of Muslim civilization is now well recognized and most books and well-constructed documentaries on that had all been mostly made in the West. In contemporary research itself, more credence is given to cross-country studies. Many Western scientists also travel to Africa and Asia to conduct development studies involving randomized control trials and ethnographic studies.

#### **Proposition 2: Only Islamic knowledge is enough for revolutionary change to become world leaders**

The noted scholar argues from the Holy Qur'an (Qur'an, 5:3) that "Allah Almighty promises us that the Qur'an contains complete and perfect guidance, for all times to come" (Zaman, 2021, p. 84)<sup>(2)</sup>. Upon careful reading of the verse, it appears that the intended message of the verse is not to make this argument. Even while explaining dietary rules, the Holy Qur'an does not give an extensive list of *halal* and *haram*. It only mentions those things which are not clean and pure, and about which humans using their intellect alone may have erred in making correct judgements about these things.

(2) Part of the verse is translated as: "Today, I have perfected your religion for you, and have completed my blessing upon you, and chosen Islam as Deen (religion and a way of life) for you".

For instance, is the meat of a dead animal also lawful? Is swine meat lawful like that of other farm animals? It eats both plants and animals, unlike cows, goats, and sheep which eat plants. Is it lawful to consume blood inside the body of a lawful animal? The Qur'an clears the confusion by prohibiting meat of dead animals, swine, and blood.

Furthermore, as a reminder to *tawhīd* and to cleanse the heart from any semblance of polytheism, Muslims are asked to utter the name of Allah with whose permission alone we can take the life of a living being for our genuine needs rather than for pleasure.

In economic and other matters of life, the Holy Qur'an and Islamic guidance is focused on morality and ethics rather than on identifying strategies, tactics, and technological ways of doing things. Even during the time of the Prophet Muhammad (ﷺ) and the pious companions (رضي الله عنهم), military strategies, tools, and articles of trade from other nations were used without any hesitation. The prisoners of war in the battle of Badar were asked to teach Muslims, and those non-Muslims surely would not have been teaching Muslims the Qur'an. *Mudārabah* and *mushārah* based contracts were prevalent among Arabs and they were used by Muslims as well.

If there have been people with views similar to that of Weber (1930), there are also others like Koehler (2014) who have even credited Islam with giving birth to some of the institutions in capitalism. Such institutions had evolved and improved over time. *Mudārah* and *mushārah* based equity partnerships have evolved into joint-stock companies. *Waqf* based *madrasahs* (schools) have evolved into trust and endowment-based colleges and universities.

On the other hand, in recent times, Muslims have embraced and assimilated banking and insurance into their economies after certain 'Sharī'ah compliance' modifications have been made. In contemporary research studies, more credence is given to cross-country evidence than evidence from a single country study. In development economics, several key economists, including 2019 Nobel laureates Esther Duflo and Abhijit Banerjee, have chiefly focused on inductive studies using randomized control trials in remote areas of developing countries.

Furthermore, citing verse 58 of chapter 10, the respected scholar writes: "[Allah] promises us that the guidance that has been granted to us is better than anything (any other knowledge) that anyone else might acquire (Qur'an, 10:58)" (Zaman, 2021, p. 84). Again, the verse does not imply what is inferred here from it. The verse mentions that material prosperity is not worth anything in comparison to Allah's mercy and grace. By not accepting Allah and showing a thankless attitude to Him, people who do not believe deprive themselves of Allah's grace and mercy and any temporal prosperity in this world cannot make up for the loss.

The verse does not mean that in no way we can use knowledge and technology created by others. Ironically, Islamic banking in its economic structure, operations, and impacts is very much like mainstream banking. It is defended like that by seeking tax neutrality for Islamic finance products in Western jurisdictions. Analysts in mutual funds utilize the different techniques to evaluate portfolios developed in seminal literature in the West. Analysts in *takāful* also benefit from actuarial science tools and techniques. In cash flow analysis, corporate finance managers in *halāl* companies, and credit analysts in Islamic banks employ the discounting techniques. We have our world-view and faith, but it does not imply that we cannot co-exist unless in a completely dominating position.

It is a misconception to think that Islam originated fourteen hundred years ago. In Islamic anthropology and worldview, humankind was given guidance through an active moral conscience and divine teachings right from the beginning of human life on earth. The purpose of human life in the Islamic worldview is to choose righteous actions through the exercise of free will. The rights of the Creator (*ḥuqūq Allah*) and rights of the creatures in the environment and society (*ḥuqūq al-'ibād*) need to be fulfilled with responsibility, sincerity and devotion. Those people who fulfill these commandments will excel in the life hereafter. Afterlife accountability will establish absolute justice.

As a reminder and proof, some messengers were sent to establish this divine appraisal in the world, as well upon the direct recipients who do not accept the truth even after conclusive evidence and proof. The

Prophet Muhammad (ﷺ) was sent as the last messenger. The divine appraisal for his nation came through military conquests which also became a way to distinguish the hypocrites from the true followers.

Taking a generalized inspiration from these military conquests, contemporary movements in political Islam have not only put many Muslim countries in trouble, but presented a distorted picture of Islam. All messengers were successful in delivering the same message of *tawhīd* and afterlife accountability. No alternate proof or argument against *tawhīd* could have been put forward ever. The Holy Qurʾān's fundamental message of the oneness of Allah and afterlife accountability is a continuation of every previous messenger's message.

**Proposition 3: Morality is rooted in Islamic economics, and western social sciences undermine morality and favor individualism, selfishness, and greediness**

The intellect and moral conscience both are given by Allah. Even without reading the Qurʾān, non-Muslims also know morality and often act morally. Furthermore, by using intellect, if something useful is made, then one must not forget that intellect as well as matter is not our creation. Therefore, there is no reason to claim hegemony over moral conscience since moral consciousness is an innate part of every human's personality. That is why, the Holy Qurʾān urges us to act on *ma'rūf* and avoid *munkar* without actually giving a comprehensive list since we acknowledge them through Allah-given moral conscience.

Sometimes, we fall into a comparison trap, especially comparing the theory of Islamic economics with particular practices of capitalism, where the comparison can show the former in a more positive light regarding equity, justice, fairness, responsibility, and morality. It will be fair to only compare reality with reality and ideals with ideals.

Where we err, is in comparing the ideals of Islam with only the cherry-picked reality in the West. In the recent past, several conferences were organized for developing a human development index inspired by Islamic values and *maqāsid al-Sharī'ah*. All such studies found that when it came to the rule of law, governance, civil rights, and women's rights, many

of the developed countries in Western Europe performed well and many of the even middle-income and high-income Muslim majority countries did not.

#### 4. Misunderstandings about Economic Theory in the Transformative School

There are also misunderstandings about some concepts in economic theory. Scarcity implies that there are multiple uses of resources and not all possible uses can be simultaneously satisfied. Indeed, there is no scarcity concerning needs. Food per capita availability has increased over time, and we only live in a smaller part of the land on earth. There is still plenty of vacant space. There is scarcity only concerning wants, but they can be controlled. Preferences are amenable. Wants are shaped by culture and values. There are voices in the West that talk about responsible consumption and the '*economy of enough*'. The UN's Sustainable Development Goal (SDG) 12 focuses on responsible consumption and production. It is correct that relative scarcity is a point of view and not a brute natural fact that we cannot control.

Furthermore, it is argued that the Islamic economic framework emphasizes cooperation whereas, market economics favors competition. The market is a mechanism to exchange private goods which are non-rival and non-excludable. Sellers compete to win buyers based on quality and price. This improves product quality as well as drives technological innovations to reduce costs. Competition is misconceived as a kind of a war. The prefix 'cut-throat' is added to give an impression that it is destructive. Cooperation between sellers, as in cartelization, is inimical to consumers. Words alone do not employ goodness or badness alone. For instance, the Holy Qurʾān mentions that in punishing a killer, there is life (Qurʾān, 2:179). It is because it saves others from this heinous crime.

Zaman (2021, pp. 95-96) also gives an example of profiteering in the pharma sector. He writes: "many essential life-saving medicines which cost only a few dollars are priced at hundreds of dollars to maximize profits in the USA. This is because of the monopoly power of *big pharma*, protected by the law".

There is economic reasoning behind that which can also be considered. The innovator with a positive externality idea needs incentives to engage in laborious work involving initial capital investment. Once

the scientific and technological breakthrough is achieved, mass scale production can be carried out at a very low marginal cost. It takes a very little amount of money to copy software on disks. But, if the seller is asked to sell only at marginal cost, there will not be any inventions in the first place due to lack of profits that can overcome the laborious efforts and R&D (research and development) expenses.

Take the case of any country with a high incidence of piracy. The indigenous software industry will not develop. Many Muslim majority countries have skillful programmers who tend to seek work in the Silicon Valley and regions where there are copyright laws and patents. On the other hand, we also need to take into account the fact that public insurance, and free or highly subsidized public health facilities funded by progressive taxation are the ways through which welfare states cater to affordability needs.

We need to show whether private to private donations, by appealing to hearts through transformative education, can indeed provide the required funds and achieve efficient and consistent resource allocation as compared to funding public goods and services via progressive taxation in an impersonal, but systematic way. If private voluntary donations are uncommon in the West, it could mean there is not much of a need for that in the presence of mandatory progressive taxation and wide access to public health and services.

Poverty in China, India, Bangladesh, and other regions in South East Asia has decreased in recent years. These countries have also achieved sustainable high economic growth rates. Hunger and poverty are observed to be increasing in Muslim majority regions as compared to non-Muslim majority regions. Despite resourcefulness in some Muslim majority countries, there is less money that pours out of them in poverty relief and hunger elimination. Unfortunately, some of the military conflicts are among Muslim majority countries themselves causing destruction, loss of human lives, and chronic poverty to Muslims by Muslims.

One of the most important unresolved issues in Muslim civilization has been the peaceful transfer of power. Unfortunately, the transition of political authority is often marred with conflicts in history.

Historical evolution in social science has brought with it a means to transfer political power peacefully without conflicts. This in itself paves the way for sciences to flourish.

In commenting on conventional finance institutions, Zaman (2021) writes:

The bank is an institutional embodiment of the pursuit of wealth and acquisitiveness which form the spirit of capitalist society. It encourages people with wealth to acquire even more wealth, and uses the mechanisms of interest and insurance to insulate them from all the risks. (p. 94)

This comment ignores the fact that financial institutions like banks reduce search costs, monitoring costs, and contract enforcement costs by providing efficient intermediation between two agents in society with inter-temporal cash flow mismatch. Islamic banks work more or less on a similar pattern as conventional banks. There is not much room for making a case against conventional banking and in favor of Islamic banking by such comments.

The cost of obtaining finance in Islamic banking is either higher than conventional or competitive at best. The returns shared with depositors are either lesser than conventional or competitive at best. Through the forces of demand and supply, it is easier to explain that. In products that are perceived as close substitutes and serve the same needs, prices should tend to gravitate towards similar levels.

Stackelberg's model can be used to explain why Islamic banks tend to match the price level of conventional banks. The lead firm or sector with a bigger market share can engage in price wars, but the smaller firms would tend to match the price of the leading firm or sector.

Why do Islamic bankers ask for tax neutrality? One can explain through the demand and supply diagram that how additional tax costs or loss of tax savings can affect demand for Islamic banking products. To give another example, the lack of use of equity financing despite encouragement in the literature can be attributed to loss aversion as found empirically in OIC countries (Shaikh et al., 2018, p. 539).

Asad Zaman contrasts commercial conventional banks with *waqf* and ignores Islamic banking. As far as *waqf* is concerned, in most countries, it no longer



exists in the first place. Even where it exists, it is mostly dormant. Now, Muslim economists make the case for corporatizing the institution of *waqf* to make it more efficient and responsive. Even when a valuable real estate is endowed for public benefit, its utilization and sustainability becomes problematic under the traditional jurisprudential rules where exchange, substitution, and flexibility in resource allocation in contrast to the directive of the *waqif* (endower) are issues that do not have a universal consensus on one single ruling.

There are mosques based on *waqf* in South Asia where there is no direct socio-economic benefit emanating from these *waqf*. Since there is diversity in schools of religious thought in South Asia, most mosque administrators do not favor the centralization of the *zakāh* and *waqf* administration as the current status-quo keeps them financially sustainable by receiving *zakāh* funds directly for the sustainability of their own institutions. These ground realities also need attention.

If banks do not serve poor people with credit, there are social finance institutions and public safety nets to do the same. Many countries in the West have public insurance and unemployment benefits. Progressive income taxes redistribute income from the rich to the poor. The marginal tax rate can go up very high for larger income slabs.

Our institution of *zakāh* also has potential, but it is proportional and does not apply to every form of wealth as per traditional understanding. Complex and diverse juristic opinions on contemporary forms of wealth and income further complicate the system and leave potential loopholes.

In this backdrop, Muslim states hesitate to fully rely on and centralize *zakāh* collection and administration. Religious institutions, especially in South Asia, having limited funding and patronage from the state, also rely on *zakāh* funds for achieving financial sustainability. Thus, the potential of collection as well as the broader socio-economic redistribution objective is not fully achieved with private allocations, and it mostly contributes to funding financial sustainability and education in religious schools. Unfortunately, the ‘transformative school’ is so much preoccupied with the criticism of Western social science that it is not yet keen to resolve issues in revitalizing the Islamic institutions to solve the economic problems of Muslims.

Zaman (2021) also mentions *takāful* in the comparison of Islam’s cooperative spirit versus capitalism’s ‘competition’ spirit. Regarding *takāful*, the respected scholar writes:

The Islamic concept of *takāful* is based on mutual cooperation, and helping each other. Parties to a *takāful* contract pool money for use when any member is in need, according to loosely defined rules. Following the Islamic ideals for self-sufficiency, members would hesitate to take from the pool, except on occasions of necessity. This is the reverse of moral hazard. Similarly, on the basis that money in the pool would be considered as *ṣadaqah jāriyah* (permanent charity), members who have very low risk would be happy to put in money into the pool, with the intention of helping others. This is the opposite of the adverse selection problem. (p. 95)

This is a simplistic way to look at the structure. A *takāful* company incorporates itself as a profit-making corporation. Issues of moral hazard and adverse selection are also there in *takāful* which are mitigated with the same risk management protocols and actuarial science tools and techniques as in insurance companies. The respected scholar criticizes insurance companies for using the law of large numbers for their operations; whereas, the same principle is also used in *takāful*. Many *takāful* operators are not large enough and, hence, they often look for reinsurance from conventional reinsurance companies. That tells us something about the role of the law of large numbers. The premiums are priced at market competitive rates. Often, they are higher than conventional rates due to the smaller spread of risk in small-sized *takāful* companies and the high cost of reinsurance. It is hard to build the case for ‘co-operative’ versus ‘competition’ spirit from the practice of both. Should we look for it in cooperative trade among Muslim countries? Unfortunately, one of the most dormant trade blocks is the Organization of Islamic Conference (OIC).

Zaman (2021, p. 96) also compares the view of labor in both Islamic and capitalistic societies. He writes: “The vast majority of people must labor to provide for their families. The capitalist labor market deprives human beings of dignity, and makes them wage-slaves, who are forced by necessity to sell their lives for money”.

Many of the Muslim majority countries were the last to abolish slavery. Instead of paying heed to the Qur'ānic guidelines (Qur'ān, 24:33) of *mukātabah* (freeing slaves if they wish by paying any token amount), traditional jurisprudence developed detailed rules to follow in trading slaves as was the custom. Indeed, Islam took all measures, as highlighted in the Qur'ān to gradually eliminate slavery; but Muslim societies could not expedite the process as much as was expected as per the Qur'ānic guidelines. Unfortunately, remnants of that custom can still be experienced by non-native workers in some parts of the Muslim world. Some even lose past dues of remuneration, personal assets, and the opportunity of safe travel back home.

Citizenship for migrated labor inside OIC countries is hardly possible. Several hundreds of thousands of workers from Pakistan, Bangladesh, India, Indonesia, Malaysia, and elsewhere have found worthwhile employment as well as immigration rights and citizenship in Western countries.

During the last half-century, a major research theme in human resource management is to study ways of improving employee engagement, employee motivation, devising flexible work designs, bringing systematic career paths, bringing objective performance appraisal, and even technology-assisted recruitments. Venture capital, private equity and micro-finance allow access to capital for self entrepreneurship. Divisible investments through stocks and mutual funds allow people to be part of large-scale investments. Employee stock ownership plans and employee buyouts also allow ownership stakes and sharing in long-run growth. Of course, there are plenty of issues that need attention in corporate governance. But, by falling into the comparison trap of comparing our ideals with their practice where they fall short, we may remain blind to a lot of beneficial developments in social science.

Zaman (2021) also compares the Islamic ideal of 'service' versus the capitalistic ideal of 'profits'. He writes:

The production of goods is a service to the creation of Allah. The firm owner and laborers are jointly engaged in an act of worship. All laborers, from those who sweep the floor, to those who own the million-dollar machinery, are equal as partners in

the production of services. When the firm is conceptualized as motivated by service, it will not sell harmful products for profits, nor will it produce excessive pollution, harming the population for private profits. (p. 96)

The respected scholar thinks that the right education can alone change and transform practice completely. Unfortunately, as Zaman also laments, right now we do not see such transformation. Part of the reason is legalistic reasoning to look at every matter. The respected scholar calls for *ijtihad* in contemporary matters. But, legalistic reasoning alone is not enough to create a wider vision of morality and empathy.

If we look for examples of the 'service' and 'partners to greater cause culture', we will have to either go into the distant past of our history, or look at examples in the West where often, senior public officials mingle with the general public, ride in public transport, and carry out their household chores themselves. On the other hand, if we want to see examples of lavish consumption of public money, we need to look no further than our own societies.

### **5. Aversion to Mainstream Economics Methods in Transformative School**

Many Muslim economists advocate for the development of a distinct methodology and even for specific methods of analysis. Furqani and Haneef (2019) think that what needs to be done is to develop the foundations of Islamic economics based on the sources of knowledge in Islamic epistemology and within the Islamic worldview. Al-Saati (2019) opines that even the methods of analysis need to be distinct.

Since these distinct methods are not yet available, Islamic economics literature, on the theoretical front, is stuck at either reinventing fault lines in neoclassical economics, which is an overworked task originally credited to behavioral economists, or to presenting the ideal principles of economic behavior in Islam.

Even this is an overly repeated task originally credited to Islamic scholars or at most, to the first generation of Islamic economists.

At its heart, this tendency in the research literature is spearheaded by the 'transformative school' for three plausible reasons. First, it is feared that if assumptions that idealize or at least mention human tendencies, such as the pursuit of self-interest, are

taken up in the models, they will focus attention towards self-centric choices and legitimize greediness, accumulation, and inattention to social problems and ills. The ‘me-first’ approach could boil down to the ‘me-only’ approach if the worldview in the background treats the existence of life as a chance occurrence with no objective morality unless what serves the social order and the collective interest in the society. Hence, there is a strong urge to incorporate the Islamic worldview and Islamic precepts into the theoretical models. If doing that is seen as difficult in mathematical modeling, then the tendency is to leave the model rather than commit to the neoclassical model under a secular worldview.

The second aspect is that Muslim economists realize that, by and large, there is a discrepancy between actual and ideal behavior in Muslim society. Hence, this is not an unknown. What is important is the transition and transformation towards the ideal behavior and, thus, towards the ideal society and economy. Therefore, what is needed is greater awareness and consciousness of the required and the desired expected behavior. At the same time, education about fault lines, contradictions, and lack of predictive usefulness of mainstream neoclassical models will serve to release the mind of Muslims towards the need for catching up.

The third aspect is the fear that every analytical piece of work in Islamic economics needs to be either knowledge created based on *uṣūl al-fiqh*, or to be just an elaboration or articulation of only its useful, beneficial, and promising aspects. It is presupposed that every endeavor in *fiqh* is also universally valid like the knowledge from primary sources of knowledge, i.e., the Qur’ān and Sunnah. Thus, there is hesitation in having a critical look at our own prevalent interpretations of the Islamic economic institutions. It is presupposed that the only thing left is to institutionalize Islamic institutions like *zakāh*, *waqf*, and inheritance laws which will reduce inequalities of income and wealth. Additionally, this might involve banning interest, and converting conventional debt-based contracts to Islamic debt-based contracts in public and corporate finance, and the resultant financial system will not have any of the ills that are found in the conventional finance system. Hence, very few studies

look at the practical problems that may be found when institutionalizing ideals of equity-based financing via *mudāra-bah* and *mushārakah*, or ideals of *zakāh* and *waqf* systems.

However, it seems that the hesitation about descriptive studies is unwarranted. Within the same optimization analysis, there are ways to make the framework better by keeping it focused on the analysis of economic choices alone. Thus, religious, spiritual, or pro-social choices are not necessary to be dealt within the utility framework. It is not necessary that the resources, monetary as well as potential labor, cannot be utilized for charities, volunteering, and religious activities, such as prayers, religious travel, or time spent in seeking and delivering religious education, for instance.

The distinction of *ḥalāl* and *ḥarām* will lead to some markets as open and some markets as missing. The *ḥarām* use of resources can be axiomatically filtered out of the analysis. If drugs are not allowed in an economy, it does not mean that the economic reasoning would altogether be inapplicable to the other legal goods and services. Therefore, after setting aside all non-economic choices outside of the domain of economic analysis, the economic choices undertaken on choosing *ḥalāl* goods and services, and *ḥalāl* investment options, can be analyzed within the modified integrative framework. Even while going for *hajj*, after setting aside the sum of money for travel, we may choose hotels, airlines, and travel service providers based on what price they charge, what prices are charged by substitutes, and what is the expected price level if a decision can be made flexibly concerning time.

The tendency to compare our theory with practices of other civilizations is not appropriate both on the basis of academic merit and fairness, and also with regards to even its outcomes. This approach creates more distance between cultures, makes it difficult to get the message across, and also disappoints those objective people who find it unjustified to criticize one civilization for every problem of underdevelopment, while the practical realities in the Muslim society and economies have many internal problems caused by us.

## 6. Alternate Paths and the Way Forward

Susanto (2020) thinks that for Islamic economics to develop its distinctive identity, it is necessary that its foundation is rooted in the Islamic worldview. But, instead of waiting for an actual Islamic economy to develop practically, the author favors instigation of research in Islamic economics before that. He favors four approaches to concentrate on in developing Islamic economics.

Firstly, Islamic economics should focus on presenting the ideal economic system with its institutions and their administration along with the ideal expected behavior of economic agents, such as Muslim consumers and Muslim entrepreneurs. Secondly, there is a need for comparative empirical studies on actual versus the ideal state in economic behavior as well as in the working, outcome, and socio-economic effects of the institutions. Thirdly, there is a need to uncover the reasons for the discrepancies. Fourthly, there is a need to develop sound policies and ways to overcome those discrepancies.

In this approach, the first brand of literature will take major guidance from Islamic sources of knowledge. The second brand of literature may very well employ some of the methods and tools of conventional economics after modification and additions in descriptive and empirical studies. Efforts in economic statistics can also help in operationalizing those variables for which data in conventional economic statistics are not readily available. The third brand of literature may employ qualitative analysis along with quantitative analysis. The fourth brand of literature will employ both the Islamic sources of knowledge including *fiqh*, as well as empirical analysis to reevaluate evidence in comparative studies. It will also be focused more on inductive and action-based research rather than on deductive research.

This approach to developing Islamic economics paves way for taking Islamic economics forward by: (i) accommodating analytical studies and tools where appropriate, (ii) including the role of Islamic sources of knowledge and *fiqh*, (iii) retaining disciplinary distinction, and (iv) keeping the focus on problem solving and need fulfillment. Thus, there is no dichotomous choice between all and nothing. There is room for integration while keeping the distinction.

Khan (2013) also highlights that one way of creating this distinction is to refer to the solutions toolbox for economic policymaking in the Islamic economics framework. If there is a deviation from the ideal state in actual economies versus an ideal Islamic economy, then the policy tools in Islamic economics need to be utilized in a way that reduces the discrepancy between the actual and the ideal state. For instance, Islamic economics emphasizes basic need fulfillment. It implies that everyone shall be able to afford and use necessities like minimum calorie intake. Thus, if Muslim economies face hunger and extreme poverty, then Islamic social finance institutions like *zakāh*, *waqf*, and *sadaqah* along with their institutional administrations, should feature in policy design and response.

Rafikov and Akhmetova (2020) explicate that, even in conventional economics; the ideal scenarios do not exist in reality. Reality is different from the ideal markets, such as perfect competition, an ideal consumer who maximizes utility to the last unit of currency spent, and ideal firms which do not waste, do not create externalities, and can predict demand so accurately while maximizing profits that they do not end up with any surplus supply. Yet, perfect competition, rational behavior, and instantaneous adjustment towards market equilibrium are the basic assumptions upon which theories and empirical models are built. Therefore, there is a case for ideal presuppositions as a benchmark in developing the theory of Islamic economics as well. However, as per Friedman (1953), the utility of a model is not in its assumptions, but in its power to predict. Though, it is suspected that if ideals in conventional economics do not occur in reality, and hence, do not give economists the leverage to work as dentists in suggesting tailor-made and precise fixes, the Muslim economists may also not find that their theoretical models do any better in prediction.

Therefore, if the theoretical edifice is just a discussion-starter and to provide a broad qualitative prediction of the direction of change rather than a measurable and precise forecasted change, then focus can be laid more on inductive and empirical studies by employing experiments, randomized control trials, and agent-based modeling. In such a case, Islamic economics need not worry much about the actual-ideal discrepancy and, thereby, work to reduce it with

Islamic policy tools grounded in *maqāsid al-Sharī'ah* and moral framework which is potentially more robust and objective.

### 7. Is Integrative Framework an Appropriate Way Forward?

The integrative framework is useful for descriptive studies about the economic behavior of actual human beings making economic decisions in markets. This framework aptly separates economic and non-economic decisions. This distinction does not necessarily depend on the type of resource, i.e., economic and non-economic, but on objective, i.e., economic versus non-economic (spiritual, pro-social, and altruism, for instance).

However, in some cases, the allocation of resources could be driven by pure spiritual stimuli, e.g., spending on *hajj* travel. But, to fulfill this spiritual need, some economic goods will be purchased from the markets. All else remaining the same, one would prefer to economize on airfare, accommodation, and food. For instance, if an online app delivers the same airline ticket, hotel room, or food brand more cheaply than the other, then it would be chosen while one is making the *hajj* journey.

In some other cases, the allocation of resources, driven by spiritual motivations, might not involve buying an economic good, such as making donations. In that case, avoiding such non-economic, but real and significant decisions outside of the economics framework is a useful separation for analytical clarity and tractability.

This framework allows the possibility that self-interest can be pursued within morality and values. Let us take an example of the separation of decisions based on motives in the integrative framework. Even if a person spends only 25% of his income on self-consumption, and on earning a return on investment, the person would try to economize resources by not paying more than what is necessary for a particular *halāl* good and service if the available alternatives are all alike. Likewise, the person would choose to buy from among the different *halāl* goods and services those products which he/she prefers.

As a producer, the person would not choose to hire extra labor and extra machinery than what is

needed since the cost budget has limits and compels a carefully planned choice of inputs. If more profits can be earned from the allocation of cost budget in a productive enterprise, then the choice behavior can consider marginal analysis.

In producer theory and analysis, the framework of constrained profit maximization is a useful framework, after necessary modifications, to analyze why firms build new plants, re-engineer production processes, invest in research and development, innovate, merge with other firms, acquire other businesses, introduce new products, advertise, and give discounts and promotions. Transformative education can potentially alert about ethics in decisions, but cannot itself enable objective analysis and decision making.

These decisions and activities by firms routinely happen in the economy and are not a figment of the imagination. The modified framework of constrained profit maximization is one way to contemplate and analyze the outcomes of these particular decisions.

Most definitely, if that framework is adopted in the Islamic economics framework, more constraints can be added to incorporate Islamic values and norms. For instance, in the production set, *harām* goods will be excluded. In factor returns, fixed compensation to money capital in the form of *ribā* will be excluded. In the cost function, investible resources can be set aside for *zakāh*, *sadaqāt*, and *waqf* which will be deducted to have a measure of investible resources using which particular factors of production can be employed.

The integrative framework will not allow economics to suggest normative values. The job of economics would be limited to explaining the economic behavior in the marketplace. In the integrative framework, self-less behavior would not be treated as irrelevant, irrational, or unreal. At the same time, this integrative framework also does not model human economic behavior by being unnecessarily rigid about potential economic choices made by humans within the ethical limits. It avoids the other extreme view that humans will have no regard for their self-interest whatsoever. Islamic teachings discourage the unrestrained pursuit of self-interest. However, Islamic teachings allow flexibility within the *halāl* choice set.

The theoretical description of consumer theory and producer theory in the integrative framework will introduce Islamic injunctions and ethos into the analytical framework. Would it create a problem in estimating general equilibrium if some economic resources and their exchange remained excluded from the asset, labor, and goods market?

To answer this concern, it is important to appreciate that in many empirical research areas, there is no need and relevance for the general equilibrium framework. It can be good for expositional purposes, but one should not be handicapped by it. Thus, in many empirical research areas in Islamic finance, a general equilibrium framework is not required.

For instance, most of the contemporary research in development and environmental economics is not driven by a general equilibrium framework. Esther Duflo and Abhijeet Banerjee achieved the 2019 Nobel prize in economics primarily through their inductive and empirical field research using randomized control trials.

Monetary economics and public finance use general equilibrium, but with limited success, precision, and confidence. The failure of the state-of-the-art Dynamic Stochastic General Equilibrium (DSGE) models in predicting economic events and outcomes is a case in point. Money is not always neutral. The quantitative theory of money does not hold necessarily, as the less than anticipated impact of quantitative easing on inflation showed in the decade following the great financial crisis of 2007-2009.

Most consumers engage in satisficing behavior, adopt rational inattention to focus on a few details, and keep a shorter-term decision horizon with dynamic adaptation. The representative agent does not represent most individuals anywhere. Forward-looking intertemporal consumption behavior and Ricardian equivalence are challenged by scores of empirical studies.

Even though development economics uses general equilibrium in the theoretical formulation, for instance in the Solow Growth Model and New Growth Theory, the policy is largely driven by differential diagnosis, randomized control trials, and action research.

## 8. Conclusion

This paper reviewed the propositions in the transformative school. It contends that it is not worthwhile to disregard, discard, and demean developments in social science and institutions on their source of origins alone. It is also not quite productive and even fair to compare Islamic ideals with cherry-picked practices in capitalistic societies. Transformative educational agenda can perhaps be included in business ethics curricula, but markets exist and consumers and producers make economic choices in markets that determine certain market outcomes. Demand and supply were discussed in political economy and even by Keynes without any optimization analysis. Microfoundations of demand and supply can be built on alternate premises as well. But, it is not appropriate to completely disregard consumer choices about *halāl* goods and services, investor choices to invest in *ṣukūk*, *halāl* stocks and Islamic mutual funds, and household choices to seek cooperative insurance via *takāful*. Firms make decisions, such as building new plants, re-engineering production processes, investing in R&D, innovating, merging with other firms, acquiring other businesses, introducing new products, advertising, and giving discounts and promotions. Such decisions need to be analyzed. A four-stage problem-solving approach could be a productive path to follow in future research. It can embed both the Islamic sources of knowledge as well as analytical and empirical tools for the research studies. The integrative framework has the potential to incorporate Islamic injunctions and also allow room for analytical studies.

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## مراجعة للمدرسة التحويلية في الاقتصاد الإسلامي

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المستخلص. تُحلل هذه الورقة وتناقش بعض القضايا المهمة المتعلقة بمنهجيات الاقتصاد الإسلامي والتيار الاقتصادي السائد. كما تُقدّم مُراجعةً تحليليةً للمُقاربات المنهجية المختلفة المقترحة في أدبيات الاقتصاد الإسلامي لاستخدامها في بناء الأسس النظرية لهذا العلم. تُستعرض الورقة عمل المدرسة التحويلية على وجه الخصوص، كمقاربة منهجية مميزة. كما أنها تقوم بتحليل المقترحات المختلفة المطروحة في هذه المدرسة. تدعو الورقة إلى تبني منهج حل المشكلات والتعددية المنهجية من خلال فصل الخيارات الاقتصادية التي يتم إجراؤها باستخدام الموارد الاقتصادية، والخيارات غير الاقتصادية التي يتم إجراؤها بواسطة الموارد الاقتصادية كذلك. يمكن تحليل الخيارات الاقتصادية في إطار مقارنة تكاملية بعد إدخال بعض التعديلات المطلوبة على أدوات التحليل الاقتصادية السائدة. أما فيما يتعلق بالخيارات غير الاقتصادية فإنه لا ينبغي دراستها في إطار الأدوات الاقتصادية السائدة، لعدم مناسبتها وقدرتها على تحليل مثل هذه الخيارات. في مثل هذه الحالة يمكن إجراء الدراسات الاستقرائية، والتجريبية باستخدام أدوات إحصائية وأدوات الاقتصاد القياسي حيث تكون مناسبة دون وجود قيود أيديولوجية. وأخيراً هناك دعوة مفادها أن "الإنسان المسلم الاقتصادي" يجب عليه الابتعاد عن الرهينة. إن "الإنسان المسلم الاقتصادي" هو إنسان يرغب في العيش ضمن قواعد وضوابط عقيدته الإسلامية، ومع ذلك فإن لديه احتياجات اقتصادية واحتياجات روحية -أو غير اقتصادية.

الكلمات الدالة: الاقتصاد الإسلامي، الاقتصاد النيوكلاسيكي، الاقتصاد السلوكي، منهجية علم الاقتصاد، تعظيم المنفعة، تعظيم الربح.

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