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The Western Economic Thought and its Response from the Muslim World: An Over view

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Abstract: ***European history has had a tremendous impact on modern economic theory, in shaping the questions asked, as well as the questions not asked; in delimitations of boundaries; and in methodology. This influence is not generally recognized because of the assumption of the universality of Western experience, as well as the pretensions of economics to the status of 'science,' and an assumption that scientific truth is objective. The historical roots of Western economic theory are necessary because large portions of modern Islamic economics are responses to Western economic theory, albeit informed by different historical experiences. This paper tends to highlight the development of the western economic thought over the centuries and its response from the Muslim world particularly in post colonial period.***

Keywords: Western Economic Thought, Historical Development, Islamic Economic Thought, Response to Western Economics

1. Introduction

In the sixteenth century, religion was central to human thought both in Europe and in the Islamic world. Subsequent events in Europe led to radical changes in ways of thinking in the West. Violent religious conflicts and disenchantment with religion among intellectuals in Europe led to a search for alternatives to religion as a basis for social organization. Secular thought found replacements for traditional, religion-based answers to the questions of appropriate standards for individual and social behavior, suitable forms and purposes of political and economic organization, as well as a myriad of others. Economic theory and other social sciences emerged as means for providing clarification of and support for answers to the questions that religion could no longer provide.

The transition from religious to secular thought in Europe deeply influenced the development of social science. Secular thought emphasized the diversity of human goals and the primacy of freedom to choose. Wealth was seen as an essential component of freedom, as it allows individuals to do whatever they desire. Thus the pursuit of wealth became a social goal and a means of obtaining maximum freedom in a secular society. The contrast with Christian values, which denounce acquisitiveness and greed, has been spelled out by Tawney [1]. Insensibly, failure to prescribe what is to be done with wealth led to the pursuit of wealth itself becoming a goal, instead of a means to a goal.

Thus the answer to the fundamental economic question of what is to be done with surplus wealth became 'use it to generate more wealth'. Even though this answer is patently absurd, it is nonetheless deeply believed by many. Economics as Religion by Nelson [2] provides many illustrations of how deeply held this type of belief has become and also how economic theory is described in theological terms by many leading economists. While it seems a priori obvious that wealth should be used to improve welfare, satisfaction, and happiness of individuals and society, some economists, notably Friedman[3], condemn diversions from the goal of pursuing wealth to pursue social goals in no uncertain terms.

Even though these ideas are easily seen to be products of particular European historical experiences with religious conflict, they are commonly thought to have universal applicability. The need to justify and rationalize European conquests led to the idea of the White Man's burden: that European culture, thought and socio-political systems are ideal forms and must be spread to the rest of the world. Several authors described stages of growth which would be followed by 'primitive' societies to reach European levels of development. For example, Hegel[4]saw history as a teleological process driven towards the goal of achieving European ideal forms of society. In the End of History, Fukuyama [5] suggests that, with the dissolution of Soviet Union, we have arrived at this goal. All of these lines of thought converge on the idea that European thought is applicable to all societies, instead of being a product of special events of European history.

The emergence of the social sciences in the West is closely tied to the 'Enlightenment project', and attempts to find rational grounds on which to base social, political and economic structures. Theories in the social sciences often abstract from Western historical experiences, and often take Western institutional structures for granted as background. Mitchell, writes that "The possibility of social science is based upon taking certain historical experiences of the West as the template for a universal knowledge." [6] The impact of history on the development of social sciences in the West has been ably traced by Manicas [7] and also Gordon [8]. Wallerstein [9] argues for the necessity of changing disciplinary boundaries and content in social science. Thus, there is strong evidence of the imprint of Western history on modern social science.

2. The Emergence of Economics in Europe

European history has had a tremendous impact on modern economic theory, in shaping the questions asked, as well as the questions not asked; in delimitations of boundaries; and in methodology. This influence is not generally recognized because of the assumption of the universality of Western experience, as well as the pretensions of economics to the status of 'science,' and an assumption that scientific truth is objective. The historical roots of Western economic theory are necessary because large portions of modern Islamic economics are responses to Western economic theory, albeit informed by different historical experiences.

European loss of faith in the certainties of religion (termed the 'death of god' by Nietzsche) led to the search for alternative certainties on which knowledge could be reliably founded. Scientific knowledge was to take the place of sacred knowledge, and an intensive effort on many fronts was made to establish the superiority, objectivity, and certainty of scientific knowledge, and to distinguish it from other forms of knowledge [10] Mirowski[11] has described how the tremendous prestige of Newtonian physics resulted in a self-conscious effort by economists to model their discipline along similar lines.

Logical positivism and related philosophies have been tremendously influential in shaping Western social science in the twentieth century. In general, philosophy of science was an attempt to give rigorous analytical and philosophical backing to the European intuition that scientific knowledge is different from, and superior to, other types of knowledge. In particular, scientific knowledge rests on objectively verifiable facts, and trustworthy logical derivations from these facts alone. Other types of human knowledge utilize intuition and unverifiable assumptions, posit the existence of unobservable entities, and may utilize unreliable or false logic. One of the explicit goals of logical positivists was to discredit religion as a source of knowledge. Attempts to accomplish this goal of differentiating between scientific and other types of knowledge eventually failed on many different fronts. This failure, the 'death of logical positivism', has impacted on different fields within the social sciences in different ways. While many disciplines have made suitable adjustments to their methodologies and moved away from positivist precepts, mainstream economics continues to espouse positivist principles. [12]

Schools of Economic Thought

Historians categorize economic thought into periods and schools. This categorization is helpful for the purpose of exposition. For most of history, economics did not have a separate identity apart from social thought in general. Even as late as the eighteenth century, Adam Smith viewed economics as a subset of jurisprudence. Economics attained its distinctive identity when it came to be identified with a self regulating market process, and the discovery of the market as a self-regulating process was an eighteenth-century phenomenon. However, the seeds of economic analysis were sown long before, in ancient Greece, the cradle of Western civilization.

Greek Economic Thought

The theory of economics as a separate science never developed in Greece. The consideration of economic problems was incidental to the pursuit of politics and ethics. In so far as Greek thinkers treated such subjects, their theories reflect the comparative simplicity of their economic environment. The Greeks were led to deal with their problems more in terms of men than in terms of things, and thus their economic vision was sometimes clearer and truer than our own. Aristotle struck the keynote in Greek economic thought in stating that the primary interest of economy is human beings rather than inanimate property. The economic ideas of Greek thinkers were not arrived at as a result of a purposeful study of the problems of material wealth. All economic relations were considered primarily from the standpoint of ethics and state welfare. The citizen was not regarded as a producer, but only as a possessor of wealth. The Greeks felt that science which deals with wealth, so far from being a 'gospel of Mammon,' necessarily begins and ends in the study of man [13]

Economic Ideas of Plato

Plato (428 BC – 348 BC) was a Greek philosopher of ancient times. He was also a mathematician, student of Socrates, writer of philosophical dialogues, and founder of the Academy in Athens, the first institution of higher learning in the Western world. Along with his mentor, Socrates, and his student, Aristotle, Plato helped to lay the foundations of Western philosophy and science.

Plato defined economics as Economics is the science which deals with the satisfaction of human wants through exchange, seeking so to regulate the industries of the state as to make its citizens good and happy, and so to promote the highest well-being of the whole.

In his most celebrated book the Republic, Plato gives the theory of an ideal state. As far as a state is concerned, Plato gives ideas about how to build an Ideal commonwealth, who should be the rulers of the Ideal state and how to achieve justice in the Ideal state. Plato finds the state as the more suitable place to discuss about the morality than an individual, because everything is easier to see in the large than in the small. A state, says Plato, is a man 'writ' large against the sky. The elements that make up a city correspond to the elements that constitute the individual human soul.

The justice of the city is the same as it is for the individual. For Plato, there is not one morality for the individuals and another for the state. Like the tripartite individual human soul every state has three parts which are its three classes. The elements that constitute the human soul are as follows: 1. Bodily appetite 2. Spirited elements 3. Reason. Like the tripartite individual human soul, every state has three parts such as-1.Producer class 2. Military class 3. Ruling class [14]

Plato finds the origin of the state in the various needs of people. Nobody is self-sufficient. So, to meet the various needs men created the political institution. To Plato, in the beginning there was only one class namely the producing class. Then emerged the guardian class. From the guardian class emerged the ruling class. In a state the producer class will consist of those people to whom the bodily appetites are dominant and who live for money. The producer class is made up of farmer, blacksmiths, fishermen, carpenters ashore –makers, weavers, labourers, merchants, retailers and bankers. The life of the producer class is much easier than the life of the rulers or the guardians. The life of the produce class follows the old familiar patterns of home and property, family and children, work, rest and recreation. By nature the producers have money [15]

Each member of the producer class will be educated by being taught a trade or a profession – farming, banking, carpentry-according to his or her capabilities and to the needs of the society, both of which will be determined by the guardians. The military class will be drawn from that type of men to whom the spirited element is dominant and who live for success in aggressive and courageous acts. The members of the ruling class will be drawn from that type of man to whom reason is dominant and who lives only for truth. A state should be ruled only by the elite group of the most rational. In the ideal state each of these three classes will perform a vital function on behalf of the organic totality of the state.

Selection of the ruling class Plato gives most emphasis on the selection of the ruling class. The selection of the ruling class is from all classes by natural intellectual capacity. Women as well as men possess the natural capacity of intelligence to become members of the ruling class. Plato proposes that an ideal state will be governed by a person who is highly educated, has passion for truth and has achieved the greatest wisdom of knowledge of the good. The ruler of this ideal state is called the Philosopher king.

The Philosopher king has several important functions to perform. The rulers, said Plato, should be the one who has been fully educated, one who has come to understand the difference between the visible world and the invisible world, between the realm of opinion and the realm of knowledge, between appearance and reality. The Philosopher king is one whose education, in short, has led him up step by step through the ascending degrees of knowledge of the divided line until at last he has a knowledge of the good[16]

To reach this point, the Philosopher King will have progressed through many stages of education. By the time he is eighteen years old, he will have had training in literature, music and elementary mathematics. His literature would be censored. Music also would be prescribed so that seduction music would be replaced by a more wholesome, martial meter. For the next few years there would be extensive physical and military training. At the age twenty a few would be selected to peruse an advanced course in mathematics. At age thirty, a five year course in dialectic and moral philosophy would begin. The next fifteen years would be spent gathering practical experience through public service. Finally, at age fifty, the ablest men would reach the highest level of knowledge, the vision of the good and would then be ready for the task of governing the state.

Economic Ideas of Aristotle

Aristotle (384 BC – 322 BC) was a Greek philosopher who was a student of Plato and teacher of Alexander the Great. His writings cover many subjects, including physics, metaphysics, poetry, theatre, music, logic, rhetoric, linguistics, politics, government, ethics, biology, and zoology. Together with Plato and Socrates (Plato's teacher), Aristotle is one of the most important founding figures in Western philosophy. Aristotle's writings were the first to create a comprehensive system of Western philosophy, encompassing ethics, aesthetics, logic, science, politics, and metaphysics.

The economic ideas of Aristotle are developed mainly in the following works: ‘Politics’, ‘Nicomachean Ethics’, ‘Rhetoric’, ‘Economics’ and ‘Rhetoric to Alexander’. Aristotle analyses Economics according to ethical principles and examines it micro economically and macro economically. He based economics on needs, analysed their nature and proceeded to isolate the economic goods by which economic needs are satisfied; he talks about production and the factors involved, the distribution of labour, the significance of the primary, the secondary and the tertiary sectors, and the stages in the development of the economy. He also examines the phenomenon of economy of an area, of economic development and prosperity on the basis of the financial policy. He also included the subjective perception of value, so that the influence of his intellectual work, as is shown, continues to appear up till the present time; thus he has influenced economic thought more than anyone else throughout History. The aim of Aristotle was the prosperity of the City-State along with its self-sufficiency sand the division of labour[17]

The ideas of Aristotle have had a tremendous impact on social and economic thought since the days of the Lyceum. Aristotle’s greatest contribution is his recognition of the vital importance of private property. Aristotle denounced the communism of the ruling elite advocated by Plato. According to Aristotle, Plato’s collectivist utopia runs counter to humanity multiplicity and the mutual advantage gained through market exchange. Plato himself recognized the importance of the division of labour. Plato has Socrates remark in The Republic that specialization occurs because we are not all alike; there are many diversities of natures among us which are adapted to different occupations. Aristotle outlined the common characteristics of private property that solidified his support:

1. Private property is more productive and leads to progress.
2. Conflict is inherent in communal property management.
3. Private property is intrinsic to man’s nature. The love of self, money, and property is tied to natural love of exclusive ownership. 4. Private property has existed always and everywhere. 5. Only private property allows for opportunity for moral action; to practice virtues of benevolence and philanthropy. [18]

3. Scholasticism

Scholasticism (The Schoolmen) refers to the school of economic thought that developed in Europe during the medieval period (500-1500). Scholastic thinkers are known for their moral and philosophical approach to the study of exchange, value, and ownership within the context of the time period. Of the scholastics, St. Thomas Aquinas is widely credited for his original, although sometimes ambiguous contributions to the early discussions of value, price, private property, and usury (or interest). Until the arrival of Mercantilism in the 14th century the Scholastics (or Schoolmen as they are commonly referred to today) were at the forefront of the foundations of establishing economic theory within the framework of philosophy. Probably the most influential economic thinker of the Scholastic period was a Sicilian-born Roman Catholic by the name of Thomas Aquinas. Scholasticism evolved amongst a societal structure known as feudalism. The feudal society of Medieval Europe was one in which all authority was derived from God by the church, which was headed by the Pope. The feudal system was one in which the king of a land or region delegated power, responsibility, and land grants to his royal subordinates (nobles, barons, lords, etc.). These barons would in turn sub-let land to landlords, with the understanding that the baron had full control of the land, established his own laws and taxes, and had the right to call all to serve under the crown. It was then the lowly serfs whose duty it was to tend the land and provide free labour, food, and service whenever it was demanded. The relationship between lord and serf was one dictated by custom, tradition and authority. It was this class relationship that caused religious theologians of the time to examine what moral and ethical implications were addressed when two or more parties entered into an exchange, or contract. [19]

Economic Ideas of St. Thomas Aquinas

Saint Thomas Aquinas (1225–1274) was an Italian Catholic Priest and one of the most important Medieval philosophers and theologians. He was immensely influenced by scholasticism and Aristotle and known for his synthesis of the two aforementioned traditions. Although he wrote many works of philosophy and theology throughout his life, his most influential work is the Summa Theologica.

Aquinas's economic thought is inseparable from his understanding of natural law. In his view, natural law is an ethic derived from observing the fundamental norms of human nature. These norms can be understood as the will of God for creation. An unlawful act is that which perverts God's design for a particular part of His creation. Economic transactions, according to Aquinas, should be considered within this framework, since they occur as human attempts to obtain materials provided by nature to achieve certain ends. Private property is a desirable economic institution because it complements man's internal desire for order. "Hence the ownership of possessions is not contrary to the natural law," Aquinas writes in the Summa Theologica, "but an addition thereto devised by human reason." The state, however, has the authority to maintain a legal framework for commercial life, such as enforcing rules prohibiting theft, force, and fraud. In this way, civil law is a reflection of the natural law. Further, Aquinas believed that private ownership of property is the best guarantee of a peaceful and orderly society, for it provides maximum incentive for the responsible stewardship of property. Aquinas helped relax the traditionally negative view of mercantile trade that figured prominently in, for example, Patristic thought. For Aquinas, trade itself is not evil; rather, its moral worth depends on the motive and conduct of the trader. In addition, the risk associated with bringing goods from where they are abundant to where they are scarce justifies mercantile profit. The merchant, however, must direct his profits toward virtuous ends. [20]

4. Merchantilism

Mercantilism is economic nationalism for the purpose of building a wealthy and powerful state. Adam Smith coined the term "mercantile system" to describe the system of political economy that sought to enrich the country by restraining imports and encouraging exports. This system dominated Western European economic thought and policies from the sixteenth to the late eighteenth centuries. The goal of these policies was, supposedly, to achieve a "favorable" balance of trade that would bring gold and silver into the country and also to maintain domestic employment. In contrast to the agricultural system of the physiocrats or the laissez-faire of the nineteenth and early twentieth centuries, the mercantile system served the interests of merchants and producers such as the British East India Company, whose activities were protected or encouraged by the state. The most important economic rationale for mercantilism in the sixteenth century was the consolidation of the regional power centers of the feudal era by large, competitive nation-states. Other contributing factors were the establishment of colonies outside Europe; the growth of European commerce and industry relative to agriculture; the increase in the volume and breadth of trade; and the increase in the use of metallic monetary systems, particularly gold and silver, relative to barter transactions. During the mercantilist period, military conflict between nation-states was both more frequent and more extensive than at any other time in history. The armies and navies of the main protagonists were no longer temporary forces raised to address a specific threat or objective, but were full-time professional forces. Each government's primary economic objective was to command a sufficient quantity of hard currency to support a military that would deter attacks by other countries and aid its own territorial expansion. Most of the mercantilist policies were the outgrowth of the relationship between the governments of the nation-states and their mercantile classes. In exchange for paying levies and taxes to support the armies of the nation-states, the mercantile classes induced governments to enact policies that would protect their business interests against foreign competition[21]

The growth of Mercantilism was the result of combination of factors cultural, religious, political and economic and it shall be desirable to examine these causes in some details. In the beginning of the sixteenth century Europe witnessed great religious and intellectual awakening due to Reformation and Protestantism. These two movements associated with the names of Erasmus and Martin Luther respectively which gave a great fillip to the ideas of individualism and personal freedom and went a long way in developing the concepts of property and contract rights which in turn led to the growth of commerce and free exchange. Before the emergence of these movements, the Pope enjoyed a predominant position in religion and could also interfere in the worldly matters. With the rise of Protestantism the monetary aspect of life was emphasized and a bid was made to confine the authority of the Pope to the religious matters alone and prevent his interference in the economic and political matters. [22]

Even the international position of the church was challenged by setting up national churches. For example, in England

Henry VIII seized the church property and established the Church of England and himself became its spiritual head. Renaissance played even more significant role and highlighted the element of humanism. It challenged the medieval theologian concept that happiness in heaven should be preferred over worldly happiness, and asserted that happiness on this earth was to be preferred over the promised pleasures of the other world.

In other words, it emphasized the materialistic basics of the human happiness. Once the principles of humanism and individualism were accepted, a large number of writers, artists, philosophers emphasized the economic basis of the society in their works and shook the foundations of the edifice of Church Theology. In the economic sphere the decline of feudalism greatly contributed to the growth of mercantilism. The feudal system was characterized by economic self-sufficiency, agricultural production and absence of exchange economy. The agriculturists were required to work free of charge on the fields of the lords for a stipulated period. They were also required to work as soldiers for the lords in times of war. As there were no organized industries and even commercial crops were not in much demand, these agriculturists worked for local self-sufficiency in food grains. In the absence of organized markets the manufacture was undertaken chiefly to meet the local requirements. This resulted in the growth of an independent domestic economy based on local self-sufficiency. Above all, there was no effective state organization. In the cities and towns the guilds and municipalities tried to regulate the trade between different localities. However, with the expansion of commerce divergent individual trading interests came to the fore. Almost all of them looked for a strong central authority to protect them against their rivals. In the absence of a national government this was not possible and the relationship was decidedly a weak link. The growth of commerce and development of domestic economy gave rise to the problem of labour and distribution. But probably the most important factor which stimulated the development of mercantilism was the emergence of the exchange economy. This led to development of international trade, which in turn encouraged large scale production. For a fuller utilization of the available economic resources it was felt that the economic life should be regulated. The urge for new marks led to the discovery of new islands and countries and the development of colonialism. [23]

Whereas the economic literature of scholasticism was written by medieval churchmen, the economic theory of mercantilism was the work of secular people, mostly merchant businessmen, who were privately engaged in selling and buying goods. The literature they produced focused on questions of economic policy and was usually related to a particular interest the merchant and writer (in one person) was trying to promote. For this reason, there was often considerable scepticism regarding the analytical merits of particular arguments and the validity of their conclusions. Few authors could claim to be sufficiently detached from their private issues and offer objective economic analysis. However, throughout the mercantilism, both the quantity (there were over 2000 economic works published in 16th and 17th century) and quality of economic literature grew. The mercantilist literature from 1650 to 1750 was of distinctly higher quality, these writers created or touched on nearly all analytical concept on which Adam Smith based his Wealth of Nations, which was published in 1776. The age of mercantilism has been characterized as one in which every person was his own economist. Mercantilism can best be understood as an intellectual reaction to the problems of the times. In this period of the decline of feudalism and the rise of the nation-states, the mercantilists tried to determine the best policies for promoting the power and wealth of the nation, the policies that would best consolidate and increase the power and prosperity of the developing economies[24]

5. Physiocracy

The Physiocrats were a group of economists who believed that the wealth of nations was derived solely from agriculture. Their theories originated in France and were most popular during the second half of the 18th century. Physiocracy was perhaps the first well developed theory of economics. They called themselves économistes (economists) but are generally referred to as Physiocrats in order to distinguish them from the many schools of economic thought that followed them. Physiocrat is derived from the Greek for “Government of Nature”. The principles of Physiocracy were first put forward by Richard Cantillon, an Irish banker living in France, in his 1756 publication Essai sur la nature du commerce en géneral (Essay on the Nature of Commerce in General). The ideas were later developed by thinkers such as François Quesnay and Jean Claude Marie Vincent de Gournay into a more systematic body of thought held by a united group of thinkers.

The Physiocrats saw the true wealth of a nation as determined by the surplus of agricultural production over and above that needed to support agriculture (by feeding farm labourers and so forth). Other forms of economic activity, such as manufacturing, were viewed as taking this surplus agricultural production and transforming it into new products, by using the surplus agricultural production to feed the workers who produced the extra goods. While these manufacturers and other non agricultural workers may be useful, they were seen as 'sterile' in that their income derives ultimately not from their own work, but from the surplus production of the agricultural sector. The Physiocrats strongly opposed mercantilism, which emphasized trade of goods between countries, as they pictured the peasant society as the economic foundation of a nation's wealth. The Physiocrats enjoyed some support from the French monarchy and frequently met at Versailles. Adam Smith, who visited France as a tutor and mentor to the Earl of Buccleigh's son's Grand Tour, was heavily influenced by the ideas of the Physiocrats, and Karl Marx cites them as a reference in Das Kapital; they popularized the modern version of the labor theory of value[25]

6. The Classical School

The Classical School, which is regarded as the first school of economic thought, is associated with the 18th Century Scottish economist Adam Smith, and those British economists that followed, such as Robert Malthus and David

Ricardo. The main idea of the Classical school was that markets work best when they are left alone, and that there is nothing but the smallest role for government. The approach is firmly one of laissez-faire and strong belief in the efficiency of free markets to generate economic development. Markets should be left to work because the price mechanism acts as a powerful 'invisible hand' to allocate resources to where they are best employed. In terms of explaining value, the focus of classical thinking was that it was determined mainly by scarcity and costs of production. In terms of the macro-economy, the Classical economists assumed that the economy would always return to full-employment level of real output through an automatically self-adjustment mechanism. It is widely recognised that the Classical period lasted until 1870. [26]

Adam Smith

Adam Smith was born in Kirkcaldy, Fife, Scotland. Smith was the Scottish philosopher who became famous for his book, 'The Wealth of Nations' written in 1776, which had a profound influence on modern economics and concepts of individual freedom. In 1751, Smith was appointed professor of logic at Glasgow University, transferring in 1752 to the chair of moral philosophy. His lectures covered the field of ethics, rhetoric, jurisprudence and political economy, or 'police and revenue.' In 1759 he published his Theory of Moral Sentiments, embodying some of his Glasgow lectures. This work was about those standards of ethical conduct that hold society together, with emphasis on the general harmony of human motives and activities under a beneficent Providence. Smith moved to London in 1776, where he published An Inquiry into the Nature and Causes of the Wealth of Nations, which examined in detail the consequences of economic freedom. It covered such concepts as the role of self-interest, the division of labour, the function of markets, and the international implications of a laissez-faire economy. 'Wealth of Nations' established economics as an autonomous subject and launched the economic doctrine of free enterprise. Smith laid the intellectual framework that explained the free market and still holds true today. He is most often recognized for the expression 'the invisible hand,' which he used to demonstrate how self-interest guides the most efficient use of resources in a nation's economy, with public welfare coming as a by-product. To underscore his laissez-faire convictions, Smith argued that state and personal efforts, to promote social good are ineffectual compared to unbridled market forces. In 1778, he was appointed to a post of commissioner of customs in Edinburgh, Scotland. He died there on July 17, 1790, after an illness. [27]

In his book 'Wealth of Nations', Adam Smith puts his ideas of free market and examines the conditions, which lead to an industrial revolution. Two hundred – fifty years before he raised a question that still remains central in today's world. Why do residents in one nation have higher incomes then those in other? Why do those incomes persistently rise in some countries and fluctuate around in others? According to him, in a free market a Government should have a limited proper well defined role in the society. Government should provide national defence, the administration of justice and public goods. In other words Government should provide only those goods and services which a free market cannot provide. In 'Wealth of Nations', Smith talks about two important aspects of the economy, which are division of labour and 'invisible hand'.

According to Smith division and specialization labour is very important. Unlike the modern approaches to technical advances linked to the capital investment process, Smith emphasizes the importance of the organization of production as representing the source of technical progress. The division of labour refers to the fresh forms of specialization separating the production process into compartments, each one performing different tasks with varying rates of profits for comparative advantages in the trade. Income level of any country depends on the level of degree of division of labour they have attained. The method to run a free economy is competition, buyers and sellers striving against each other to gain more customers and profits. When sellers compete, they lower prices improve their products and offer specialized deals to gain more customers. The sellers are motivated by the self-interest, they think about what is in there for me? The factor of self-interest comes into play. Instead of being motivated by the fixed prices by the government, the sellers choose prices and run businesses to make as much profit as possible. Any product people demand will be supplied by someone ready to earn profit. Thus everything people need is fulfilled without Government getting involved in the business. This system was called 'free market' by Smiths, which is run by an 'Invisible Hand'. The self – interest is the invisible hand that runs the free – market, which means the markets are self-regulated [28]

Even though Smith realized that free markets are not perfect, he understood that generally speaking, more than any other alternatives available free market concept is able to advance wealth and welfare. Instead of gains for both parties arising from each transaction, citizens must pay whatever service is offered in return. This leads to poorer lives. The simple truth is that, when free to do so, individual and families look after themselves than distant, too powerful government. Smith's theory of wages was a form of the Iron Law of Wages which held that wages are by and large equal to the subsistence level of wages. (If wages exceed the level that is just enough to keep the worker and his dependents alive, there will be an increase in population that will drive wages down to the subsistence level. If wages fall below what the workers need to stay alive, population will fall and wages will rise to the subsistence level.) This meant that any increase in total output went not to the workers but to capitalists who would save and invest in machinery that would make possible further division of labour and technological progress. Smith thought of rent as a residual that is leftover after wages and profits had been paid out of total output. Wages would be reduced to the subsistence level, as I said before. Competition will gradually reduce the rate of profit to a low level that would also be uniform across all industries. Therefore, only those who earn rent income would benefit from progress. In his book 'the Theory of Moral Sentiments', Smith argued that as people are able to imagine what others are going through, they are able to empathize with the sufferings of others. When the experiences of others are felt as our own experience, our instinctive pursuit of self-interest can lead us to pursue the interests of those others.

So, it is perfectly consistent to believe that human beings pursue self-interest and are generous towards others. Moreover, apart from the human ability to empathize with the sorrows of others, the sheer practicality of peace -the fact that we realize that it is necessary for prosperity-may be enough to encourage good behaviour. As one might expect from Smith's conviction that markets were extremely efficient, he was in favour of a government that did not hamper the working of the market. However, Smith emphasized the fact that the government should maintain law and order, ensure the defence of the nation from foreign enemies, erect and maintain public works that private citizens will not build, and subsidize the education of those who could not afford it. [29]

Classical economics as the predominant school of mainstream economics ends with the 'Marginalist Revolution' and the rise of Neoclassical Economics in the late 1800's. In the 1870's William Stanley Jevons' and Carl Menger's concept of marginal utility and Leon Walras' general equilibrium theory provided the foundations. Henry Sidgwick, F.Y. Edgeworth, Vilfredo Pareto and Alfred Marshall provided the tools for Neo classical economics.

Neo Classical

The neo-classical school of economic thought is a wide ranging school of ideas from which modern economic theory evolved. The method is clearly scientific, with assumptions, and hypothesis and attempts to derived general rules or principles about the behaviour of firms and consumers. For example, neo-classical economics assumes that economic agents are rational in their behaviour, and that consumers look to maximise utility and firms look to maximise profits. The contrasting objectives of maximising utility and profits forms the basis of demand and supply theory. Another important contribution of neo-classical economics was a focus on marginal values, such as marginal cost and marginal utility. Neo-classical economics is associated with the work of William Jevons, Carl Menger and Leon Walras. [30]

New Classical

The New Classical School is built largely on the Neoclassical School. The New Classical School emphasizes the importance of microeconomics and models based on that behaviour. New Classical economists assume that all agents try to maximize their utility and have rational expectations. They also believe that the market clears at all times. New Classical economists believe that unemployment is largely voluntary and that discretionary fiscal policy is destabilizing, while inflation can be controlled with monetary policy. [31]

Monetarism

Monetarism is sometimes also referred to as the Chicago School (of economic thought).Monetarism is most widely associated with Milton Freidman and supports primarily a free market economy. Monetarist economists believe that the role of government is to control inflation by controlling the money supply. Monetarists believe that markets are typically clear and that participants have rational expectations. Monetarists reject the Keynesian notion that governments can "manage" demand and that attempts to do so are destabilizing and likely to lead to inflation. [32]

Austrian School

The Austrian School is an older school of economics that is seeing some resurgence in popularity. Austrian school economists believe that human behaviour is too idiosyncratic to model accurately with mathematics and that minimal government intervention is best. The Austrian school has contributed useful theories and explanations on the business cycle, implications of capital intensity, and the importance of time and opportunity costs in determining consumption and value[33]

7. Socialists

Socialism arose in the late 18th and early 19th century as a reaction to the economic and social changes associated with the Industrial Revolution. While rapid wealth came to the factory owners, the workers became increasingly impoverished. As this capitalist industrial system spread, reactions in the form of socialist thought increased proportionately. Although many thinkers in the past expressed ideas that were similar to later socialism, the first theorist who may properly be called socialist was François Noël Babeuf, who came to prominence during the French Revolution. Babeuf propounded the doctrine of class war between capital and labour later to be seen in Marxism. Socialist writers who followed Babeuf, however, were more moderate. Known as 'utopian socialists,' they included Saint-Simon, Charles Fourier, and Robert Owen. Saint-Simon proposed that production and distribution be carried out by the state. The leaders of society would be industrialists who would found a national community based upon cooperation and who would eliminate the poverty of the lowest classes. Fourier and Owen, though differing in many respects, both believed that social organization should be based on small local collective communities rather than the large centralist state of Saint-Simon. All these men agreed, however, that there should be cooperation rather than competition, and they implicitly rejected class struggle. In the early 19th century Numerous utopian communistic settlements founded on the principles of Fourier and Owen sprang up in Europe and the United States; New Harmony and Brook Farm were notable examples. Following the utopians came thinkers such as Louis Blanc who were more political in their socialist formulations. Blanc put forward a system of social workshops (1840) that would be controlled by the workers themselves with the support of the state. Capitalists would be welcome in this venture, and each person would receive goods in proportion to his or her needs. Blanc became a member of the French provisional government of 1848 and attempted to put some of his proposals into effect, but his efforts were sabotaged by his opponents. The anarchist Pierre Joseph Proudhon and the insurrectionist Auguste Blanqui were also influential socialist leaders of the early and mid-19th century. [34]

The term 'Socialism' made its appearance in print in England in 1827. Five years later, the term was used for the first time in a French publication. It is no accident that the socialist idea --and the socialist movement--first appeared in England and France. For socialism was a product of two revolutions in human affairs, each with their respective roots in those two countries: the industrial revolution in England and the popular-democratic revolution in France.

The French revolution of 1789-1799 involved the most massive popular struggles that had yet been seen in history. Rooted in popular hatred of an oppressive monarchy, the revolution rose on the backs of the masses of poor people in Paris who united under the banner of 'liberty, equality and brotherhood'. Beginning as a rebellion against the abuses of the monarchy, the revolution grew into a massive challenge to all forms of oppressive authority-- whether it was that of lords, priests or factory owners. Initially, the battle against the monarchy unified large sections of society. As the revolution advanced, however, a new ruling group tried to halt the process in order to maintain their grossly unequal system of property and power. As a result, the popular movement divided into conservative and revolutionary camps. In the conservative camp were those who saw freedom simply in terms of the freedom to own property. In the revolutionary camp were those who represented the Paris poor and who recognised that freedom was impossible without equality; that it was meaningless to talk of liberty if this was confined to the right of some men and women to starve to death while others grew rich off the labour of others. [35]

Out of the French Revolution, then, emerged the essential socialist idea that democracy and freedom require a society of equality. The French radicals recognised that genuine freedom presupposed the liberty of all to participate equally in producing and sharing the wealth of society. They understood that if some had the unequal right to own and monopolise land, wealth or factories, then others might just as unequally be condemned to a life of drudgery, misery and poverty. But a society of equality requires a state of abundance. So long as economic life remains relatively backward, equality can only mean the common hardship of shared poverty. A healthy and thriving popular democracy requires a state of prosperity in which all the basic needs of people can be satisfied. Without a certain level of economic development, therefore, the French revolutionaries' demand for liberty and equality remained utopian. It was only with the enormous economic development unleashed by the industrial revolution in England that a society based upon equality and abundance became a realistic possibility. [36]

Marxian Political Economy

The political and economic philosophy of Karl Marx and Friedrich Engels in which the concept of class struggle plays a central role in understanding society's allegedly inevitable development from bourgeois oppression under capitalism to a socialist and ultimately classless society is generally referred to as Marxian Political Economy model. Political economy was the original term used for studying production, buying, and selling, and their relations with law, custom, and government, as well as with the distribution of national income and wealth. Political economy originated in moral philosophy. It was developed in the 18th century as the study of the economies of states, or polities, hence the term political economy. In the late 19th century, the term economics came to replace political economy, coinciding with the publication of an influential textbook by Alfred Marshall in 1890. Earlier, William Stanley Jevons, a proponent of mathematical methods applied to the subject, advocated economics for brevity and with the hope of the term becoming 'the recognised name of a science.' Today, political economy, where it is not used as a synonym for economics, may refer to very different things, including Marxian analysis, applied public-choice approaches emanating from the Chicago school and the Virginia school, or simply the advice given by economists to the government or public on general economic policy or on specific proposals. A rapidly growing mainstream literature from the 1970s has expanded beyond the model of economic policy in which planners maximize utility of a representative individual toward examining how political forces affect the choice of economic policies, especially as to distributional conflicts and political institutions. It is now an area of study in universities. [37]

Karl Marx

Karl Heinrich Marx (1818-1883) was born on May 5, 1818 in the city of Trier, Germany. His father was a lawyer who came from a long line of Rabbis, but had changed his faith to Protestantism in order to keep his job. Karl Marx went to the University of Bonn to study law when he was 17 years old. Here he became engaged to Jenny von Westphalen, whose father, Baron von Westphalen, influenced Marx to read Romantic literature and Saint-Simonian politics. Only a year later, Marx was moved by his father to the University of Berlin where he studied Hegelianism, influenced by Ludwig Feurbach and other Hegelians. He admired G.W.F. Hegel's dialectics and belief in historical inevitability, but Marx questioned the idealism and abstract thought of philosophy and maintained his belief that reality lies in the material base of economics. In distinct contrast to G.W.F. Hegel's concentration on the state in his philosophy of law, Marx saw civil society as the sphere to be studied in order to understand the historical development of humankind. In 1841 Marx earned his doctorate at Jena with his work on the materialism and atheism of Greek atomists.

By 1857 Marx had written an 800-page manuscript which was to become Das Kapital (Capital). This is his major work on political economy, capital, landed property, the state, wage labor, foreign trade and the world market. In the early part of the 1860s he took a break from his work on Das Kapital to work on Theories of Surplus Value, a three-volume work. This text discusses specific theories of political economy, primarily those of Adam Smith and David Ricardo. In 1867 Marx published volume I of Das Kapital, an analysis of the capitalist process of production, with an elaboration on his version of labor theory value, surplus value, and exploitation, that he predicted would lead to a falling profit rate and the collapse of industrial capitalism. Marx continued to work on Volumes II and III of Das Kapital for the rest of his life, even though they were essentially finished in the late 1860s. Friedrich Engels would publish the last two volumes after Marx's death. By 1871 Marx's daughter Eleanor, who was 17 at the time, was helping her father with his work. She had been taught at home by Marx himself, and grew up with a rich understanding of the capitalist system which would allow her to play an important part in the future of the British labor movement[38]

For Karl Marx, the basic determining factor of human history is economics. According to him, humans - even from their earliest beginnings - are not motivated by grand ideas but instead by material concerns, like the need to eat and survive. This is the basic premise of a materialist view of history. At the beginning, people worked together in unity and it wasn't so bad. But eventually, humans developed agriculture and the concept of private property. These two facts created a division of labor and a separation of classes based upon power and wealth. This, in turn, created the social conflict which drives society. All of this is made worse by capitalism which only increases the disparity between the wealthy classes and the labor classes. Confrontation between them is unavoidable because those classes are driven by historical forces beyond anyone's control. Capitalism also creates one new misery: exploitation of surplus value. For Marx, an ideal economic system would involve exchanges of equal value for equal value, where value is determined simply by the amount of work put into whatever is being produced. Capitalism interrupts this ideal by introducing a profit motive - a desire to produce an uneven exchange of lesser value for greater value. Profit is ultimately derived from the surplus value produced by workers in factories. [39]

A laborer might produce enough value to feed his family in two hours of work, but he keeps at the job for a full day - in Marx's time, that might be 12 or 14 hours. Those extra hours represent the surplus value produced by the worker. The owner of the factory did nothing to earn this, but exploits it nevertheless and keeps the difference as profit. In this context, Communism thus has two goals: First it is supposed to explain these realities to people unaware of them; second it is supposed to call people in the labor classes to prepare for the confrontation and revolution. This emphasis on action rather than mere philosophical musings is a crucial point in Marx's program. As he wrote in his famous Theses on Feuerbach 'The philosophers have only interpreted the world, in various ways; the point, however, is to change it. [40]

Marx has broadly distinguished four different stages through which the society has passed. These are primitive communism, slavery, feudalism and capitalism. The stage of primitive communism is characterized by a classless society. The means of production are socially owned. If there was any division of labour, it was limited to family. In course of time pastoral habits developed. People learnt how to tame animals. People learnt weaving and rudimentary forms of mining developed. All these led to the development of exchange. With the change in the forces of production, there was a great increase in the demand for labour, to carry on the new productive activities. This could not be satisfied under the existing form of economic society. The widening field of production brought slavery into existence. In other words, primitive communism was changed into slavery. Marx was of the view that capitalism was destined to face disintegration ultimately. Marx believed that capitalism contained the seeds of its own destruction. He held that capitalism will disintegrate because of its inherent conflicts and contradictions [41]

Keynesian Economics

Keynesian economists broadly follow the main macro-economic ideas of British economist John Maynard Keynes. Keynes is widely regarded as the most important economist of the 20th Century, despite falling out of favour during the 1970s and 1980s following the rise of new classical economics. In essence, Keynesian economists are sceptical that, if left alone, free markets will inevitably move towards a full employment equilibrium. They Keynesian approach is interventionist, coming from a belief that the self-interest which governs micro-economic behaviour does not always lead to long run macroeconomic development or short run macro-economic stability. Keynesian economics is essentially a theory of aggregate demand, and how best to manipulate it through macro-economic policy [42]

With the recent economic crisis, there has been much talk of John Maynard Keynes and his economics. Keynes figured out the causes of the Great Depression and in doing so revolutionized the field of economics. According to Keynes, classical economics (basically that summarized by Alfred Marshall, including Ricardo, Mill, Edgeworth, and Pigou) addresses only a special case of the economy, while his is a more general theory. The classical theory of employment says the labor market is just another market: people get paid what they make and people only work if they get paid enough to make it worth it. Since it seemed unlikely that society had run out of money-making jobs, it was assumed that unemployment was caused either by people not knowing where the jobs were (frictional unemployment) or insisting on being paid more than they could make (voluntary unemployment). The classicals believed in Say's Law which state that supply creates its own demand. If there are people around willing to work, jobs will spring up to make use of them. If people are unemployed, it must be because they're refusing to take the job. [43]

Keynesian economics is the view that in the short run, output is influenced by aggregate demand (total spending in the economy). In the Keynesian view, aggregate demand does not necessarily equal the productive capacity of the economy. Keynes contrasted his approach to the 'classical' economics that preceded his book. Keynesian economists argue that private sector decisions sometimes lead to inefficient macroeconomic outcomes. So it requires active policy (fiscal policy) by the government, in order to stabilize output over the business cycle. Keynesian economics advocates a mixed economy – predominantly private sector, but with a role for government intervention during recessions. The advent of the global financial crisis in 2008 has caused resurgence in Keynesian thought. Prior to the publication of Keynes's General Theory, mainstream economic thought was that the economy existed in a state of general equilibrium. This perception is reflected in Say's Law. Keynes's theory was significant because it reversed the mainstream thought of the time and brought about a greater awareness that problems such as unemployment are not a product of laziness, but the result of a structural inadequacy in the economic system. He argued that there was no guarantee that the goods that individuals produce would be met with demand and unemployment was a natural consequence. He saw the economy as unable to maintain itself at full employment and believed that it was necessary for the government to step in and put under-utilised savings to work through government spending. Keynesians therefore advocate an active stabilization policy to reduce the amplitude of the business cycle. According to the theory, government spending can be used to increase aggregate demand, thus increasing economic activity, reducing unemployment and deflation. [44]

John Maynard Keynes

John Maynard Keynes was an English economist and is the author of "The General Theory of Employment, Interest and Money" (1936). As a result of the influence of this work, he became the most influential economist of the twentieth century. Written during the height of the depression, it offered a new explanation of the depression and the unemployment that plagued it. Keynes' new theory probably also appealed to economists because it provided an alternative to the traditionally held view that unemployment can and should be eliminated by a drop in wage rates. Keynes new theory conveyed a politically much more pleasant solution to the problem of unemployment. According to Keynes, the solution to unemployment was a growth in government spending. The particular form of government spending advocated by Keynes was for the government to purposely adopt a policy of budget deficits which he called "fiscal policy." To arrive at this seemingly simple conclusion, Keynes developed a highly complex argumentation brimming with new economic terms and concepts of his own devising, such as "multipliers," "consumption and saving functions," "the marginal efficiency of capital," "liquidity preference," "I-S curve," and many others. The essence of Keynes' theory, however, involves a shift from classical economics' concern with the production of wealth to a concern with the consumption of wealth. According to Keynes, Say's Law is not true; that is, supply does not create its own demand. Rather, according to Keynes, supply is capable of outstripping demand, with the result that goods remain unsold, and production and employment are correspondingly cut back. As a result, the solution to unemployment, according to Keynes, is not to reduce wages and prices, as the Classicals advocated, but to increase consumption through the spending of money by the government. [45]

8. Response from The Muslim World

The formation of Islamic economics was a reaction to Western penetration of the Islamic world in the modern era. Beginning in the middle of the nineteenth century, several Western countries established their own banks in order to support their commercial activities. For example, the British Empire established the Imperial Ottoman Bank (1856) in the territory of the Ottoman dynasty and the Imperial Bank of Persia (1889) in the territory of the Qajar dynasty. The establishment of such Western banks, which charged interest, was a grave problem for Muslim intellectuals. Since the rise of Islam in the seventh century, the doctrine of Islam has prohibited any transactions including *riba*. In the context of Islamic jurisprudence, the concept of *riba* is generally considered to imply some sort of inequality and defined as some sort of banking interest in the modern context. Muslim intellectuals focused on the relationship between this implication of *riba* and the function of interest in the Western banking operations, and questioned whether transactions with interest were forbidden due to the *riba* factor.

This problem was discussed not only in the context of interest-based wholesale finance for industrial modernization, but also interest-bearing retail finance such as fixed deposits. For example, during the early stages of the Anglo-Egyptian Condominium (1899-1955) the Post Office Savings Bank in Sudan provided a special service that allowed depositors to reject the interest on their accounts. [46] As another example, Rashid Rida, the editor-in-chief of Al Manar magazine, reported that when the Egyptian government introduced interest-bearing postal savings, called *Sanduq al-Tawfir*, in the first decade of the twentieth century, more than three thousand depositors rejected the interest. [47]

Another damaging consequence of the attempt by economists to emulate the physical sciences in the West has been a general failure to appreciate the possibilities and potential for change and transformation in human beings. Human beings are free to choose in ways not determined by their past. Studying the laws of motion for societies requires that this possibility be denied. In many of the social sciences, the importance of human agency and the potential for changes in cultural and group behaviour are recognized. However, these contemporary trends have not had any impact in economics. The idea that there are natural laws governing economics, which is at the heart of modern Western economic theory, has had grave consequences. Shouldering responsibility for enjoining the good and prohibiting the evil, and for working to transform human beings from a materialist to a spiritual perspective, is fundamental to the message of Islam. This creates a great gap between Islamic and Western views on economics [48]

The birth of Islamic economics as we know it today can be dated to the early twentieth century. The needs of liberation movements gave a distinct shape to Islamic thought all over the Islamic world. It was necessary to argue that Islam required Muslims to struggle for freedom, and that it offered a better way of life than the dominant Western systems of capitalism and communism. This forced Muslim thinkers to delineate and distinguish Islamic socio-political and economic systems. Although these issues have been discussed by many Muslim thinkers, two major figures devoted substantial energy and time to developing the basis and defending the need for a distinct Islamic economic system, Mohammad Baqir Al-Sadr in his book "Our Economy" [49] and Sayyid Abul A'la Maududi [50] in numerous books and articles. Chapra [51] summarises this historical background and the views of Maududi, and gives citations to the latter's numerous works. Chapra also remarks on the courage it took to formulate an Islamic system and defend it against the dominant and apparently tremendously successful Western systems in the early twentieth century. The founders of Islamic economics (Al-Sadr & Maududi) agree that the focus of Islam is on human and spiritual development, and the purpose of an economic system is to promote justice and equity. Both believed that applications of Islamic laws and guiding principles in the economic sphere would bring advances in human welfare and be superior to Western systems for handling economic affairs, which promote only material welfare.

In the post-colonial era, Muslims have (differing degrees of) freedom to handle their economic affairs. Western methods of organizing economic affairs and Western institutions are often in conflict with Islamic laws and, more fundamentally, Islamic concepts of socio-political and economic organization. Efforts to transform these organizations and institutions have led to both theoretical and practical developments in Islamic economics. In states where Muslims have had political power and live in sufficient numbers, fully or partially Islamic systems have resulted. In other situations, Muslims have used private and market-oriented means rather than government policies to create economic institutions in conformity with Islamic law. These three situations (fully Islamic governments, a mixture of secular and Islamic institutions, and purely private market based Islamic institutions) have led to the establishment of different types of economic institutions [52]

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