

# THE NEED FOR A NEW ECONOMIC SYSTEM

by

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## **1. THE IMPERATIVE**

Human well-being has been the undisputed objective of all societies. There is however a difference of opinion on what constitutes well-being and how it can be realized. Even though material ingredients are not the only constituents of well-being, the secularist perspective of the present-day world emphasizes mainly these. It is felt that well-being could be ensured if certain material goals are realized. These include elimination of poverty, fulfillment of the basic needs of all individuals, full employment, equitable distribution of income and wealth and growth with stability. No country, around the world, irrespective of whether it is rich or poor, has however been able to realize even these material goals.

This failure is made all the more conspicuous by macroeconomic imbalances and economic instability. The developing countries are further plagued by difficult debt-servicing problems, which are threatening not only their future development but also the health and survival of the international financial system. In addition, practically all countries are experiencing environmental pollution which is endangering life on earth. There is also the spectre of a rising level of crime, strife, tensions and anomie.

### **1.1 Efficiency and Equity?**

The inability to realize the material goals could not be due to scarcity of resources. Resources are scarce only in a relative sense. It is generally agreed that if the available resources are used 'efficiently' and 'equitably', it should be possible to realize the material goals and to minimize the instability and the imbalances. This brings into focus a host of difficult problems related to 'efficiency' and 'equity' and the way to realize these.

Efficiency and equity in the allocation and distribution of scarce resources have hence been the principal themes of economics. These have both, however, been defined in different ways. The most logical way to define them would be within the framework of the material goals specified above. An economy may be said to have attained optimum efficiency if it has been able to employ the total potential of available human and material resources in such a way that a maximum feasible quantity of need-satisfying goods and services is produced with a long-run

sustainable rate of growth and a reasonable degree of economic stability. Optimum equity may be said to have been attained if the goods and services produced are distributed in such a way that the needs of all individuals are adequately satisfied and the inequalities in income and wealth reflect socially-agreed values without adversely affecting the motivation for working, saving, investing and undertaking enterprise. The test of such efficiency and equity lies in the ability to attain a socially more acceptable result without creating prolonged macroeconomic imbalances and further deterioration in the environment. Efficiency and equity in this sense have not been realized even in the rich industrial countries, irrespective of whether they are capitalist or socialist. The question is why?

## **1.2 The Three Questions**

To allocate resources efficiently and to distribute them equitably it is necessary to have a strategy that enables the economic system to answer satisfactorily the three well-known fundamental economic questions of what, how and for whom to produce.<sup>1</sup> The answers to these questions determine not only the allocation of resources in an economy but also their distribution between individuals as well as the present (consumption) and the future (saving and investment).

To answer these questions effectively, an economic system needs to have a strategy consisting of three indispensable ingredients. These are: (i) filter mechanism, (ii) motivating system, and (iii) socio-economic restructuring. The filter mechanism must filter all claims on resources in such a way that not only a balance is maintained between available resources and the claims on them but also the desired goals are realized through an appropriate allocation and distribution. The motivating system must be able to induce all individuals to put in their best performance and to use resources in accordance with the dictates of the filter mechanism not only when this is in their own interest but also when it is in the interest of social well-being. The socioeconomic restructuring should enable the prompt transfer of resources from one use to another until the most efficient and equitable allocation and distribution are attained.

The development of an effective strategy based on these three ingredients is

however not possible without an underlying worldview (*weltanschauung*), which controls, in the words of Arthur Lovejoy, ‘the nature ‘of man’s reflections on almost any subject’.<sup>2</sup> Differences in worldview lead to differences in conclusions about the meaning and purpose of human life, the ultimate ownership and objective of resources at the disposal of human beings, the relationship of human beings towards each other (their rights and responsibilities) and their environment, and the criteria for efficiency and equity.

Unless the worldview of a system is consistent with its desired goals, it may not be possible to develop the proper ingredients that an effective strategy needs for realizing these goals.<sup>3</sup> Systems which reflect an inherent inconsistency between their goals and their worldview are unable to bring about the fundamental adjustments in life-styles and to restructure the allocation and distribution of resources in conformity with goal realization. They are thus crisis prone.

## **2. THE PREVAILING STRATEGIES**

The two prevalent systems in the present-day world - the market system and socialism (used here for its central planning model) - have a common worldview but different strategies. In spite of the various ‘revisions’ that have taken place in these systems over the years, and the relative abundance of their resources, the countries following these systems have failed in varying degrees to realize their material goals. Their failure is not a contingent event, external to the systems. It is rather a natural and expected consequence of the flaws in their worldview and strategy. Hence, the existing systems, which themselves need, in the words of Burt, ‘to rethink a correct philosophy of man,’<sup>4</sup> cannot provide a model which may be emulated by Muslim or other developing countries who wish to realize their goals with resources that are relatively much smaller and would take decades to reach anywhere near those of the countries following these systems.

### **2.1 The Market System**

The market system is used here to refer to reformed capitalism, which is a combination of the principles embodied in *laissez-faire* capitalism and the welfare state. It relies primarily on the market mechanism for allocation and distribution of

resources, but assigns an ‘important’ role to the state to improve allocative efficiency and to minimize distributive inequities. There have, however, been considerable differences of opinion on the extent to which the state should intervene in the market. These differences have tended to narrow down in the 1980s when mounting fiscal deficits have created a disenchantment with large government role in the economy and led to a backlash against the welfare state. Intensified calls have hence been made from both the intellectual and the political platforms for liberalization or a return, as close as possible, to the classical model with ‘minimum’ government intervention. Within the perspective of the prevailing *zeitgeist*, the market system may be distinguished by its emphasis on:

- i) unhindered individual freedom to pursue pecuniary self-interest and to own and manage private property;
- ii) accelerated wealth expansion and maximum production and want satisfaction in accordance with individual preferences; and
- iii) primary role for market forces in the allocation and distribution of resources and a ‘minimum’ role for government intervention or collective value judgements.

### **2.1.1 The Worldview**

These features owe their genesis to the worldview of *laissez-faire* capitalism, which is essentially secularist. It was shaped by the Enlightenment philosophy, which placed great confidence in the power of reason to establish ultimate metaphysical truths, and tried to undermine the hold of religion as a collective force in society. Value judgments based on moral values became an anathema. Their place could not be taken by rationally-derived principles because of the difficulty of reaching consensus on such principles in pluralist societies with conflicting interest groups. Though values still continue to influence individuals in varying degrees, it is mainly in their private spheres of life.

Materialism and utilitarianism took the place of religion. This provided a logical rationale for single-minded pursuit of wealth and sensual pleasures and gave rise to the concept of rational ‘economic man’, which has served as the

kingpin of modern economics. Self-interest was the only well-spring of his action. Consumption was the highest purpose of his life, the supreme source of 'happiness', the ultimate justification for all his effort and toil. Maximizing earnings and want satisfaction became supreme virtues. Everything done by the individual toward this end was justified. Any talk of 'rights of men' was plain nonsense.<sup>5</sup> Social Darwinism thus crept into economics.

### **2.1.2 The Logic Behind the Strategy**

The pursuit of unfettered self-interest, however, had a social and religious stigma attached to it. Unless this stigma was removed the doctrine of self-interest would not have received the social blessing that it needed to be considered seriously in a Christian society. This was done by Adam Smith. He showed that if everyone pursued his or her self-interest, the 'invisible hand' of market forces would, through the restraint imposed by competition, promote the interest of the whole society, thus bringing about a harmony between private interest and public good.<sup>6</sup>

The logic behind this claimed harmony between private and public interests rested on a number of assumptions. The preferences of self-interested, utility-maximizing consumers are reflected in the market place through their demand or willingness to pay the market price. Producers respond 'passively' in their self-interest to this demand by producing at the lowest cost whatever will help them maximize their profits. The free interaction of utility-maximizing consumers and profit-maximizing producers under perfectly competitive market conditions helps determine market clearing prices for goods and services. These prices (and costs, which are also prices) serve as an impartial, value-neutral filter mechanism and lead to the production of that configuration of goods and services which is in maximum harmony with consumer preferences. These prices also automatically determine the transfer of resources from one use to another, thus contributing to their most efficient use without anyone's conscious effort or intervention.

Since the resultant configuration of goods and services reflects consumers' preferences, it is the most 'efficient' - it is not possible to improve upon it. This configuration also determines the incomes earned by the respective factors of

production on the basis of their contribution to output and revenue. At the point of equilibrium, consumer satisfactions (utilities) are maximized, supplier costs are minimized, and factor earnings (including wages and profits) are maximized. The market system, it is thus concluded, determines not only the most 'efficient' use of resources but also the most 'equitable' distribution of income in a rational and impartial manner without value judgments.<sup>7</sup> It also automatically brings about a harmony between private and public interests. There is no point in raising questions about whether this configuration satisfies basic human needs and whether the distribution is equitable because these questions cannot be answered without collective value judgments which, unlike market clearing prices, cannot be established impartially. Questions about differentials in wealth holdings are also unjustified because the wealth of individuals represents their earnings on the basis of their own or their parents' contribution to output and abstinence from consumption.

Every competitive equilibrium is considered to be a Pareto optimum - it is not possible to make anyone better off without making someone else worse off. It must hence be accepted as both 'efficient' and 'equitable'. Thus the terms 'efficiency' and 'equity' as defined within this framework do not have any relationship with the objectives of removing poverty, fulfilling needs and reducing inequalities of income and wealth. It is assumed that these objectives would be realized as a 'necessary' concomitant of 'efficiency' and 'equity'. Any outside intervention to change the status quo would necessarily lead to results which are less 'efficient' and less 'equitable'. The only acceptable way to change the status quo is within the framework of Pareto optimality - to make some people 'better off' without making anyone 'worse off'. By providing sanctity to self-interest, Adam Smith turned the eyes away from the moral intentions and social obligations of individuals to the 'unintended' consequences of the final social outcome of their actions, which would always necessarily serve the social interest. Perfect competition in a free market would be the best guarantee of general welfare. It would keep self-interest within bounds, minimize costs and prices, and thus ensure maximum efficiency and health of the system. Consequently there was no need for value judgments or government intervention. Only if the state did not interfere, only if the private entrepreneur was left free to pursue his economic goals, would

optimum welfare be attained and the interest of society adequately safeguarded. Everyone was the best judge of his interest and, if left alone, could better not only himself but also everyone else.

### **2.1.3 Flaws in the Logic**

There is no doubt that capitalism led to a long period of prosperity in the countries that pursued this system. High rates of economic growth were generally realized and there was a vast expansion in wealth. However, in spite of this unprecedented prosperity, it did not become possible to remove poverty and to fulfill everyone's needs. Inequalities of income and wealth also increased instead of declining. In addition, there has been a substantial degree of economic instability and unemployment which has aggravated the miseries of the poor. This implies that neither efficiency nor equity was realized within the framework of the definitions given earlier.

The reason behind this failure to actualize the socially-desired goals was the severe conflict between its goals and its worldview and strategy. The goals were humanitarian, based on a moral foundation, but the worldview and strategy were both social Darwinist. The claimed harmony between private and public interests was based on certain assumptions about background conditions which were false and so unrealistic that they could never become true.

### ***Individual Preferences and Social Priorities***

Firstly, it was assumed that even without certain collectively-agreed moral constraints on consumer choice, the sovereign consumer would confine his claims on scarce resources to only need-satisfaction. There would thus be no conflict between the preferences of 'rational' consumers and the social priorities in resource use. This assumption has proved to be false.

It was not realistic to assume that, even without any moral constraint, the 'sovereign consumer' would apply brakes to his wants as long as he has the ability to pay the price. Even if the sovereign consumer desires, it may not be possible for him to differentiate between 'need' and 'want' or 'necessary' and 'unnecessary' without socially-agreed criteria and without a complementary role of



the state to determine what the society can or cannot afford within the framework of its resources and the goal of universal need fulfillment. It is particularly so when a vast array of unwarranted wants, not related to real human needs, is created by businesses through advertising in pursuit of their goal of profit maximization.<sup>8</sup> The race for ostentatious consumption, which thus sets in, is supported and further exacerbated by excessive expansion of credit which the interest-based financial intermediation makes possible. This puts tremendous pressure on scarce resources and not only reduces the ability of society to satisfy needs, but also gives rise to deficits, monetary expansion, inflation, external imbalances and burdensome foreign debt.

### *Prices and Urgency of Wants*

Secondly, it was assumed that the urgency of wants of different consumers can be compared by the use of prices because each unit of currency represents a ballot. The willingness on the part of two individuals to spend an equal amount of money is assumed to indicate wants of equal urgency. This premise is questionable. Even though the urgency for milk is the same for children irrespective of whether they are poor or rich, the amount of dollar votes that a poor family is able to cast for milk is not the same as those which a rich family is able to cast for status symbols. Hence the system of balloting through dollar votes leads to a lower than the optimum quantity of milk production because of resources being diverted to the production of status symbols. Arthur Okun hence rightly observes that the markets `award prizes that allow the big winners to feed their pets better than the losers can feed their children.<sup>9</sup>

### *Equal Distribution*

Thirdly, it was assumed that there exists an equal distribution of income and wealth in the economy. Given the absence of a filter mechanism and the indiscriminate pursuit of want satisfaction, only an equal distribution of income and wealth would give everyone an equal weight in influencing the decision-making process of the market. But incomes are not, and cannot be, equally distributed. This allows the upper strata of income groups, getting a share of national income and credit significantly more than in proportion to their numerical size, to divert scarce resources, by the sheer weight of their votes, into products which are socially less desirable. The result is, as Tawney has rightly indicated, ‘a part of the goods which are annually

produced, and which are called wealth is, strictly speaking, waste because it consists of articles which though reckoned as part of the income of the nation, either should not have been produced until other articles had been produced in sufficient abundance or should not have been produced at all.’<sup>10</sup>

### *Market Imperfections*

Fourthly, it was assumed that the market operates under conditions of perfect competition, which is said to prevail if there are: many buyers, many sellers, no barriers to entry, and perfect information about the present and the future. The motive to maximize profits forces the entrepreneur in a competitive market to minimize his costs and eliminate waste. Competition prevents him from overcharging. It serves as a stick that enforces order and fair play, thus serving the consumers’ interest and thereby of the society as a whole. It acts as a self-regulating mechanism for the economy and eliminates wastage, exploitation, and excessive profits without any government intervention.

Perfectly competitive markets have however remained an unrealized dream and will most probably remain so in the future, particularly because of the tendency of capitalism to promote big business and concentration of wealth and power. Competition has been on the decline. Big business has become prominent in all industrial countries through a process of expansion which has continued nearly uninterrupted for more than a century. Several hundred giant corporations ‘play a preponderant role in the United States, Canada, Japan, and the nations of Western Europe.’<sup>11</sup> These giant corporations wield considerable social and political influence in their countries. They account for about 80 per cent of all economic activity in the United States though they comprise only 10 per cent of all business firms. However, even the activity of the remaining 90 per cent of business firms is determined in various ways by these large corporations. They dominate the American economy, whether measured in terms of capital, production, investment, new products, consumer impact, or employment.<sup>12</sup> Even in the agricultural sector, traditionally assumed to be the stronghold of family farms, the move is towards the consolidation of farm lands into fewer hands. According to Norm White, ‘government policies that favour big operations and cause more and more medium-sized farmers to go down the tube will eventually

result in a few huge conglomerates owning most of the land and controlling the food supply.<sup>13</sup> Such a vast corporate growth has far-reaching effects.

Moreover, the giant corporation is not a democratic institution. All control over the policies of these corporations rests in the hands of a few families who hold the controlling stock.<sup>14</sup> ‘In approximately 150 companies on the current Fortune 500 lists, controlling ownership rests in the hands of an individual or of the members of a single family.’<sup>15</sup> Even the professional managers of such corporations are drawn from the upper strata of society. As Andrew Hacker has indicated, the democratic social climate is ‘not reflected in the upper echelons of the large European corporations, and there were even signs that the inequality of selection was increasing rather than decreasing.’<sup>16</sup> Wealth and connections are of utmost importance in getting management positions in a large corporation. They are the tickets of admission to the inner echelons of power. Mills indicated the prevalence of the same state of affairs in the U.S. by saying: ‘The corporation is the source of wealth, and the basis of the continued power and privilege of wealth. All the men and the families of great wealth are now identified with large corporations in which their property is seated.’<sup>17</sup> Hence there is concentration of power in the hands of a small elite in the major sector of the economy, giving them an immense power to make basic product, price and investment decisions that affect the entire nation and, in fact, the world.<sup>18</sup> Large corporations are even able to escape competitive market restraints.<sup>19</sup> Many observers believe that the pricing patterns among the leading firms show a lack of competitiveness.<sup>20</sup> The large size places a limit to the entry of new firms. Huge resources are required for entry and these are difficult to muster because of the greater initial risk to which a new firm is exposed. Only the rich who have an access to vast resources of their own and also of the banking system can plan an entry. However, banks are generally reluctant to lend to newcomers because of not only uncertainty but also their vested interest in protecting their favoured large clients.

If corporate expansion had stemmed merely from the search for greater efficiency, then one might have perhaps condoned corporate expansion into vast conglomerates. But even this is not the case. According to many observers, ‘the optimum size of the efficient firm is substantially smaller than many people

believe.’<sup>21</sup> The structures of most large corporations are really the equivalent of a congeries of semi-independent companies which could have easily operated with equal, or even greater, efficiency as separate companies with an independent identity.<sup>22</sup> Moreover, ‘concentration is enhanced by the heavily interlocked nature of large business firms. Nominal competitors, for instance, usually have directors sitting on each other’s board of directors, raising the suspicion that competition is not the essence of their relationship. Interlock is further enhanced by the trust activities of banks, by trade associations, by the practice of price leadership and, occasionally, by outright collusion and conspiracy.’<sup>23</sup> If profit is an indicator of efficiency, then research has shown profit rates in industries having a large number of smaller firms to be just as high as in those in which a few big companies dominate a market.<sup>24</sup> Largeness does not therefore necessarily contribute to greater efficiency even in the capitalist sense.

The conventional interest-based banking system has provided impetus and lifeblood to the process of expansion through vertical as well as horizontal expansion and leveraged buy-outs of competitors. Banks prefer to finance a few large businesses compared with innumerable small ones. This tendency was further intensified by the low rates of interest maintained by central bank fiat during the Second World War and for nearly two decades thereafter as a result of the need to reduce the cost of servicing the public sector debt and to accelerate post-war reconstruction and development. The low rates of interest accentuated the built-in bias of giant corporations in favour of capital-intensive techniques of production and aggravated the unemployment problem in practically all industrial countries - a problem which has now become very difficult to solve.

Although theoretically the postulate is true that private ownership of means of production, when combined with healthy competition, contributes to greater efficiency in the use of resources, in practice, the market system has fostered large conglomerates, most of which may be unnecessary, and greater concentration of power. The result is, as Berle has put it tersely: ‘The capital is there and so is capitalism. The waning factor is the capitalist.’<sup>25</sup> Thus the three central pillars of capitalism have been shaken - the ultimate power of the consumer, the self-regulating tendency of competition, and the creative drive

of the entrepreneur. The individual (both as a consumer and an entrepreneur) has become ‘increasingly subordinate to the goals of the producing organisation.’<sup>26</sup>

### *Social Costs and Benefits*

Fifthly, it was assumed that the profit-maximizing producers would not disregard social costs and benefits in their accounting and that prices would not therefore reflect just private costs and benefits but rather total costs and benefits to society. This has also proved to be wrong. Prices of certain goods or services tend to be out of tune with opportunity costs and payments to resource owners tend to be far above or below the value of their contribution to real output. This has contributed in a significant way to undue depletion of non-renewable natural resources, excessive environmental pollution, and economic iniquities. It was unrealistic to assume that in an individualistic society, where most operators in the market are ‘economic men’, whose only motivating force is self-interest, whose time horizon is short, and whose social perspective is generally narrow and limited, long-run as well as social costs and benefits would not be disregarded by them in their accounting, even though these costs or benefits are extremely important from the point of view of continued social well-being. The claimed self-correcting tendency of the price system to reduce the divergence between private and social interests takes an extremely long time such that faith in this self-correcting tendency is not meaningful.

#### **2.1.4 The End of *Laissez-Faire***

As Brittan has rightly pointed out, ‘no real world market is likely to be even approximately satisfactory in all background conditions.’ The absence of background conditions led to serious distortions in the allocation and distribution of resources. A number of scholars and literary figures criticized the logic of *laissez-faire* capitalism and drew attention towards its sour fruits. Even though their criticisms led to a number of minor modifications in the system, they could not succeed in bringing about a significant change. They were therefore left behind as towering, but nevertheless ‘historic’, figures.<sup>27</sup>

Two events, however, served to wash the ground away completely from under *laissez-faire* capitalism and ushered in the welfare state. These were the Great Depression of the 1930s and the socialist onslaught. The depression led to the Keynesian revolution in economics and undermined *laissez-faire* capitalism's cherished principle of government non-intervention in the economy. Keynes argued that free-market economies could not be expected to maintain full employment and prosperity at all times. It was necessary for the government to play an important role in removing demand deficiency through deficit financing to correct the depression. Keynes, however, dealt with only one aspect of the welfare state - that of achieving full employment. According to him, the capitalist system failed only in the solution of the unemployment problem; it solved appropriately the problems of allocation and distribution. He did not therefore, believe in the need for changing other features of capitalism which did not interfere with the achievement of full employment.<sup>28</sup> The socialist onslaught however undermined the non-intervention principle further and created irresistible pressures in favour of other welfare functions of the state, even those previously performed by individuals themselves or their families and society.

### **2.1.5 The Welfare State: The Thorny Path**

The primary thrust of both these impacts has been the establishment of the welfare state or democratic socialism, leading to an expansion of varying degrees in the role of the state in all market-economy countries. This has contributed to an exponential rise in government spending. Consequently budgetary deficits have ballooned and persisted in spite of prohibitively high tax rates. These deficits have been financed by monetary expansion and borrowing. This has generated inflationary pressures, balance of payments disequilibria, and higher interest rates followed by lower growth rates and greater economic instability. These difficulties have led to a backlash against the welfare state.

The problem that the welfare state now faces is how to remove the imbalances that it has created? There being no agreed filter mechanism other than prices with the help of which to regulate aggregate demand, primary reliance is being placed on the market mechanism to remove the existing imbalances. This revival of faith in the market brings back into focus the failures and iniquities of the market and the inability of the poor to fulfill their needs. The welfare state is thus faced with a

perplexing dilemma. If primary stress is placed on the market and the welfare role of the state is rolled back to remove the imbalances, then the welfare state is back to square one - the square of capitalism from where it started. So what to do now?

The only major tool that the welfare state is left with to provide relief to the poor is a high rate of economic growth. Economic growth has accordingly received undue emphasis and has become the primary tool for reducing inequalities. However, even though the high rate of growth has raised the consumption level of the poor, it has not helped fulfill all the needs of the poor or improve income distribution. As Adelman and Morris have shown on the basis of a cross section of data, 'development is accompanied by an absolute as well as a relative decline in the average income of the poor.'<sup>29</sup> Higher growth has given a greater boost to the income of the rich because all the capitalist institutions which promote inequalities, particularly the banking system, have continued unchanged. Undue emphasis on growth has also accentuated imbalances and debt-servicing problems, and has led not only to unduly rapid depletion of non-renewable natural resources but also to excessive environmental pollution. Moreover, the prospects for maintaining, much less accelerating, the rates of growth are not very bright in the near future without increasing inflation and aggravating other imbalances.

As a result of the backlash, the welfare state has now lost much of its earlier élan. The ruling thought nowadays seems to be that the continued growth of the welfare state is neither likely nor desirable.<sup>30</sup> Harold Wilensky has reported on the basis of a study of 64 countries that in the 1970s there was already evidence of growing resistance to further expansion of state services in many rich countries.<sup>31</sup>

### **2.1.6 Lack of an Effective Strategy**

The welfare state is, nevertheless, not an option which may or may not be adopted; it is rather indispensable in every human society which wishes to realize its humanitarian goals. The secularist welfare state has faced difficulties because it could not develop an effective strategy to realize its humanitarian goals. It did not introduce any fundamental change in the worldview of capitalism. The primary reliance on government interventions and excessive spending was essentially a

patchwork to the innate secularist and social Darwinist philosophy of *laissez-faire* capitalism - a random outcome of the conflict between pluralist groups, each of which is trying to serve its maximum self-interest and to make minimum sacrifice. The anathema to value judgments continued and the self-imposed standard of Pareto optimality remained sacred. If the filtering and motivating role of moral values in moulding consumer preferences is ruled out, then the welfare state is not left with any effective mechanism that could help prevent the use of scarce resources for purposes that obstruct the realization of its egalitarian goals. There was no criterion for distinguishing the 'necessary' from the 'unnecessary', and the 'just' from the 'unjust'. If the moral obligation of family and society in fulfilling the dire needs of its members is also ruled out, then the welfare state becomes loaded with responsibilities it is not capable of shouldering. The welfare state did not recognize even means testing. It tried to provide welfare services to all, the rich and the poor alike, through increased spending by the public sector.

Initially this generated a euphoria - a feeling that the problems of both allocation and distribution had been ideally solved. They were not; the strategy was inadequate for the task. The swelling budgetary deficits resulting from increased public sector spending, not only to finance Keynesian-style demand management but also to promote higher growth and welfare services, were not accompanied by an offsetting reduction in other claims on resources. In fact the consumer culture also led to a simultaneous rise in private sector spending, leading to a decline in saving.<sup>32</sup> The interest-based banking system has served as an accomplice by its willingness to lend to both the private and the public sectors, without due regard for the ultimate use of credit, on the strength of collateral and the assumption that a sovereign debtor will not default. The excess liquidity that has thus been generated has exacerbated claims on resources and given rise to macroeconomic imbalances and instability in the foreign exchange, commodity and stock markets.

The problems of poverty and depravity have nevertheless continued and become more profound. Needs have remained unfulfilled. Inequalities have in fact risen. Socially desired priorities do not get expressed in the market place with flagrant inequalities of income and wealth. The rich are able to divert scarce resources to the satisfaction of their 'inessential' wants through the sheer weight of



their enormous purchasing power. Satisfaction of a maximum amount of wants hence becomes the primary objective of the economic system and the entire machinery of production gets directly or indirectly geared to this goal. The poor get squeezed because of their lower income and their inability to pay the market price. Even their essential needs remain unfulfilled. This lowers their efficiency and their income. They thus get entrapped in the vicious circle of poverty. The greater the income and wealth disparity, the greater the power of the rich to divert resources away from the need fulfillment of the poor if reliance is placed merely on the price mechanism to allocate resources and to remove the imbalances.

Any effort to fulfill needs and to bring about an equitable distribution is bound to hurt the rich in every society where there exists an inequitable distribution. Why would the rich agree to be worse off in a secularist, value-free society committed to the principle of Pareto optimality? To motivate them to be worse off in the interest of the well-being of others, it would be necessary not only to have socially-agreed values to which everyone stands committed but also a motivating system. Any system that overemphasizes pecuniary self-interest cannot have the kind of motivating system that is needed for socially-oriented behaviour.

There is thus a built-in tendency on the part of market forces to lead to skewness in the claims on resources in favour of conspicuous consumption. Samuelson has acknowledged this by saying: 'Laissez faire perfect competition could lead to starving cripples; to malnourished children who grow up to produce malnourished children; to perpetuation of Lorenz curves of great inequality of incomes and wealth for generations or for ever.' He further adds that 'Adam Smith had no right to assert that an Invisible Hand successfully channels individuals who selfishly seek their own interest into promoting the "public interest" . . . Smith has proved nothing of this kind nor has any economist since 1776.'<sup>33</sup> It is Galbraith's contention in *The Affluent Society* that the prevailing pattern of resource allocation in the U.S. is biased in favour of the satisfaction of artificially induced consumer wants so that basic needs are grossly neglected. Included among these are education, housing, medical care and public utilities which are essential for individual and social well-being and for future progress.<sup>34</sup>

The market system cannot therefore help the simultaneous realization of both efficiency and equity in the allocation and distribution of resources. It is necessary to change consumer preferences, public finances, investment patterns, and all economic and financial institutions in such a way that resources do not get diverted to uses that obstruct goal realization. The welfare state has been unable to bring about such a change because it did not introduce any fundamental shift in the worldview of capitalism. It relied primarily on increased public sector spending without creating an offsetting reduction elsewhere. This has led to imbalances which have now become a serious problem. Within the perspective of the market system it is not possible to remove the imbalances without either raising taxes or reducing spending. Since taxes are already high in all welfare states, the primary remedy being considered is a substantial reduction in the welfare role of the state. This remedy may not be practical for long in democratic societies where elected representatives of the people are expected to live up to the expectations of their constituencies. The solution does not thus lie in preventing the state from playing its natural welfare role in the economy, but rather in restructuring the economy and injecting a moral dimension into all uses of resources by both the public and the private sectors.

Even the introduction of values may not help reduce inequalities of income and wealth unless the financial system is also radically reformed. Stanley Lebergott explains skewness in income and wealth distribution as the result of ‘quite rational’ supply of credit to wealthy individuals.<sup>35</sup> This is a natural consequence of the interest-based financial system, which got established in the West after the Judaic and Christian stricture against interest was by-passed. Since the lender, irrespective of whether he is an individual or a banker, does not share in the risk of business, he would naturally be inclined to lend to the rich because in this case he is assured of the repayment of principal with interest. If, however, the lender shares in the risk, as he would be required to do in an interest-free profit-and-loss sharing system, he would be more concerned about the nature and profitability of the business. In this case even the poor would stand a chance.<sup>36</sup> Mishan has hence aptly stated: ‘Given that differences in wealth are substantial, it would be irrational for the lender to be willing to lend as much to the impecunious as to the richer members of society; or to lend the same amounts on

the same terms to each.<sup>37</sup> The greater flow of credit to the rich in the conventional system is a highly acknowledged fact. Galbraith, for example, says: ‘The large corporation of the planning system, when it must borrow, is a favoured client of the banks, insurance companies and investment banks.’<sup>38</sup> He further states that ‘those who least need to borrow and those who are most favoured as borrowers are in the planning system. Those who most rely on borrowed funds or are least favoured at the banks are in the market system.’<sup>39</sup> Large-scale businesses and their mentors, the banks, have however become so powerful in the market system that it is doubtful, if it can ever succeed in bringing about an equitable distribution of income by means of the cosmetic changes that it is accustomed to making. Vested interests in big business and big finance have become excessively strong both economically and politically and it may not be possible to dislodge them to introduce the radical changes necessary for better results.

## **2.2 Socialism**

While the failure of capitalism to realize its goals led to an expansion in the role of the state in the economy in market economy countries, it also led to the socialist revolution in Soviet Russia, Eastern Europe, Yugoslavia, Cuba and China. However, socialism has also failed to realize both efficiency and equity. It has rather created problems which are beyond the tolerance level of the people. It is therefore important to see the reasons for its failure.

Socialism condemned religion and its values even more than did *laissez-faire* capitalism. It did not however provide an alternative worldview other than dialectics, which is nothing but a disguised version of social Darwinism based on class conflict. It could not hence develop an effective strategy to realize its goal of a classless society where everyone worked ‘according to his ability’ and got rewarded ‘according to his needs’. The main plank of its strategy to remove the exploitation and alienation prevalent under capitalism was to prevent human beings from serving their self-interest. The only way it could think of accomplishing this was to abolish private property and the market mechanism and to replace them by state ownership of all means of production and central planning.

### **2.2.1 The False Assumptions**

Like capitalism, socialism also made certain assumptions about background conditions - assumptions which are false but do not appear to be so until they are clearly specified.

Firstly, while its analysis of the human condition implied a total distrust in the ability of human beings to manage private property within the constraints of social well-being, it was tacitly assumed that, after the introduction of socialism, the same human beings in their capacity as consumers, workers, managers, and government officials, will always be motivated to do their best for the social good without caring for their self-interest. This was highly unrealistic, and facts have amply borne out the unrealism. In a secularist system, where there is no concept of accountability before the All-Knowing God and where the total life-perspective of an individual does not go beyond the short span of this world, the inability of individuals to serve their self-interest has adversely affected their motivation and hence their initiative, drive and creativity.

Secondly, it was assumed that the state machinery will be run by a group of persons who have no axe to grind. This assumption has also proved to be false. If human beings cannot be trusted with private property for fear that they will exploit their position of strength to serve their vested interests, how can they be trusted with the responsibility to manage a whole economy and to determine the 'socially-desired' configuration of goods and services? Hence, the question posed by Karl Mannheim about 'who plans the planners?', becomes pertinent.<sup>40</sup> There seems to be no valid rationale for giving a few individuals the right to determine what the whole society should produce. If the planners are human beings, as they are bound to be, then their own preferences and vested interests will tend to get an upper hand in a system not steered by a clearly defined set of goals and values provided by Divine guidance. But even if the planners are to operate on the basis of Divine guidance, as some Muslims argued in their simple-minded justification of socialism, vesting the control over all means of production in the hands of a few individuals is too dangerous. Such an enormous power is apt to give rise to a dictatorial and inflexible bureaucracy interested in preserving its own power and benefits and oblivious to the welfare of the masses.

Thirdly, it was assumed that the central planning machinery will have at its disposal all the information about consumer preferences, production costs, and prices necessary for taking numerous decisions. This was also unrealistic. Such information does not exist and is almost impossible to collect and analyse. Hence Hayek had very rightly predicted that a socialist solution to the problem of resource allocation was impracticable simply because complete knowledge of all the relevant data would not be available to the authorities.<sup>41</sup> But even if the information were available, the task of making decisions about the allocation of resources among thousands of consumer and capital goods and services is too cumbersome and time-consuming. The system is bound to be slow in decision-making and responding to changing circumstances. Decentralized decision-making is in the best interest of society, and the price system, which allows thousands of consumers and producers to interact with each other, is able to respond more easily and readily to the needs of individuals and firms than the cumbersome centralized planning machinery.

Fourthly, it was assumed that the large general subsidies implied in the socialist pricing system would benefit the poor. This has also proved to be wrong. General subsidies have benefited the rich and the privileged persons far more than the poor whose purchases are limited.<sup>42</sup> Large subsidies are natural and implicit in the socialist planning system. According to a Soviet economist, L. M. Gatonsky, there are at least 5 million prices to be fixed in the Soviet Union and it is impossible to fix these prices coherently.<sup>43</sup> Since putting a price tag on everything from nails to tractors is a mammoth job, prices remain unchanged for years, particularly retail prices; changes in which are also politically sensitive.<sup>44</sup> The existence of large subsidies has brought a criminal waste of scarce resources. As rightly observed by Mr. Valentin Pavlov, Chairman of the Soviet state committee for prices: 'Prices play little role in creating balance between supply and demand, leading to continual shortages both for retail and wholesale goods.'<sup>45</sup>

### **2.2.2 The Frustrations**

The consequence is that even though almost all centrally planned economies were rich in human and physical resources and had the potential to satisfy all the needs of all their people, they have been continually suffering from shortages of many need-

satisfying goods. These shortages could not be removed because centralization makes the decision-making process slow, cumbersome and inefficient compared with decentralized decision-making in the market system. State ownership, as Weber had predicted, intensified the bureaucratization of economic life and imposed a deadly routine on all participants.<sup>46</sup>

By closing most legal avenues for serving self-interest, the system killed individual initiative and encountered difficulties in motivating both labour and management to try to excel in their performance. The large size of state-owned farms and enterprises led to diseconomies of scale. Their monopolistic position implied absence of competition. There was no incentive to economize in the use of inputs or to introduce innovations. Even if the management of a state-owned enterprise was anxious to be efficient, it could not do so without having the ability to take prompt decisions independently, and being able to acquire the best and the cheapest inputs and to hire the most competent and efficient workers and technocrats from wherever they were available. Management thus became an encrusted mass of officialdom used to receiving and transmitting orders. What the market does under the market system - create a link between the consumer and the independently responding producer - was missing under socialism. Also missing were the price mechanism, that emits signals, and the profit, that motivates the entrepreneur to do his best. Without both market signals and socially-agreed values, there was no basis for determining efficiently the scale of capital accumulation and its allocation among different goods and services. Decisions were thus made on the basis of political considerations and the whims of the planners.

The inefficiency of the system has now become reflected in low growth rates. The growth rates in the Soviet economy were initially high (5.8 per cent per annum) during the period 1928-1940, followed by low growth rates (2.2 per cent per annum) during 1940-50. The economy picked up after the War and returned to high growth rates of 5.7 per cent per annum during the period 1950-60. This generated an ebullience of confidence in the socialist system, which began to be heralded as the wave of the future and the model for developing countries. There has been a continuing decline in growth rates since then - 5.2 per cent per annum during 1960-70, 3.7 per cent during 1970-75, 2.6 per cent during 1975-80, and 2.0

per cent during 1980-85.<sup>47</sup> The 'corrected, but more accurate' estimates produced by Mr. Aganbegyan, one of the persons behind *perestroika* (restructuring), suggest that there was really no growth at all in the first half of the 1980s.<sup>48</sup> This has reduced the appeal of the system, particularly because the growth record of other countries like Japan, West Germany and South Korea, with vastly smaller resources, has been more impressive. Stalin's famous call in 1931 for making good the distance between the Soviet Union and the advanced countries in ten years has thus proved to be an illusion. Even Khrushchev's dream of closing the gap within the decade of the sixties remained unfulfilled.<sup>49</sup> The decline in growth rates has reversed the trend of decline in the absolute gap between the United States' and the Soviet economies; the gap has been widening in recent years.<sup>50</sup>

While the centrally-planned system has reduced efficiency, its contribution to equity has also been limited. Inequalities have been reduced only to a minor extent. The propertyless labourer continues to be a propertyless labourer. Instead of being an employee of the individual capitalist, he has become the employee of a more powerful employer, the monopolist state enterprise, with unhindered powers to punish or reward. The worker is completely divorced from the power centres, far more than in capitalist countries, where he exercises at least some influence through the labour unions and the democratic political process. His *de facto* position has in fact worsened. The wage slavery which socialism sought to abolish, continues with greater intensity. In the capitalist system the labourer is at least free to choose his employer, there being so many of them; in the socialist system he is not free to do so. If his immediate boss is benevolent, the worker may be well off; may be, because if he is more competent, works harder, and performs his duties conscientiously, he may not necessarily get a higher *quid pro quo* reward. If, however, the boss is vindictive, he has to suffer in silence. He has nowhere to go. If he fights for his rights, his problems may multiply. State socialism thus turned out to be more tyrannous than private capitalism.<sup>51</sup> Isn't this alone sufficient to increase his alienation? As Crosland, himself a socialist, has rightly indicated: 'The underlying fact of the alienation of workers from the means of production' still remains. This is because 'the control centre is separated from the workers and the possibility of exploitation, and of all the other features of 'capitalism', is present.'<sup>52</sup>

Social inequalities and class distinctions also continue unabated. As Murray Yanowitch remarked, 'Soviet society may be characterized as a class system.'<sup>53</sup> The higher and better paid jobs go, like under capitalism, to those who come from the higher stratum of society.<sup>54</sup> A number of sociological studies have demonstrated that a great majority of workers' children who had high ambitions are 'destined to remain disappointed.'<sup>55</sup> The once popular equation that state ownership would create a classless society has thus been falsified. There is no logical reason to assume that when the state expropriates all means of production, no one class will control the state.<sup>56</sup> The continuation of the class system is bound to continue in a more intensified form in a centralized system, the underlying philosophy of which is not based on any concept of human brotherhood and accountability before the Supreme Being, but rather on dialectics and the elimination or domination of one class by the other.

To reinforce all these alienating factors is, as already indicated, the absence of priority to need fulfillment. Hence housing, food and other essentials of life have been in short supply in all centrally-planned economies. The labourer has to wait in long queues to get some of his essential requirements. The powerful and the influential are however able to have a privileged access to everything through 'lavish perquisites: not only free cars and country houses, but also secret additional salaries and special shops with reduced prices and, in the case of top people, with goods completely free of charge.'<sup>57</sup>

Even in terms of education and training, the workers' children do not have as great an opportunity to be accepted in institutions of higher learning as that enjoyed by children coming from families of the higher social strata with their greater 'influence' and resourcefulness. The Soviet education system has a strong tendency to transmit economic and social inequalities across generations even when all levels of schooling are tuition free. The critical link is the family unit and its position in the hierarchy of classes and strata. Yanowitch has observed that 'the more "promising" the future occupational status associated with completion of any given type of schooling, the lower is the share of manual workers' children and the higher the proportion of non-manual strata in the student body.'<sup>58</sup>

The system has been highly unjust in other ways as well. The peasants and labourers did not only lose their lands, they also receive low prices for their products -



prices determined by officials. In the Soviet Union and, for that matter, in the entire socialist world, incomes hardly conform to need.<sup>59</sup> Inequality in the USSR may be less than that in France and the United States but is certainly not less than that in Norway and the United Kingdom.<sup>60</sup> In fact Sweezy, himself a socialist, views Soviet society as containing large disparities in income and privileges.<sup>61</sup> Under these circumstances, even the use of force has been unable to induce the peasants and the workers to put in their best. Thus the system did not only abolish private property, it has become a great source of injustice to the proletariat producers, by paying them less, as well as the proletariat consumers, by not fulfilling their needs. The 'dictatorship of the proletariat' had to suppress the proletariat himself to 'cure' his alienation. Hence Sweezy was constrained to remark that the Soviet Union has not lived up to the principles of a socialist society.<sup>62</sup>

### **2.2.3 Ineffective Strategy**

The reason for the failure is evident. The goals were not in harmony with the underlying philosophy and strategy. The goals were humanitarian - a classless society where no one exploits anyone else, where everyone works for the social good, where needs are fulfilled, where there are no inequalities of income and wealth, and where there is hence no alienation. The underlying philosophy and the strategy were however in conflict with these goals. They promoted dialectics - hatred, conflict and elimination - and transferred the management of all means of production in the hands of a privileged few. With the immensely increased power in the hands of a small proportion of the population, no motivating force to rein self-interest and serve social interest, and no socially agreed filter mechanism to guide decision-making, the system was bound to promote privileges and a power struggle to perpetuate these. Socialism had no mechanism other than force to rein human self-interest. The system was hence a non-starter from the very beginning.

Thus, while socialism provided a powerful critique of the capitalist system, it failed to provide a constructive and feasible alternative. After the destruction of the rich heritage of human values, all that has been achieved is a totalitarian state with all means of production under its control, no agreed criteria to guide state policies, no mechanism to restrain human self-interest, and all the power to be cruel, unjust

and ruthless. It was wishfully believed that such a totalitarian state will ultimately wither away. How? It was not explained. If the bourgeoisie is not willing to yield power, will the proletariat do so after getting into positions of power, more powerful than those of the bourgeoisie?

The fact is that the state, far from withering away, became ever more powerful and an instrument of oppression in socialist countries; 'the society in balance with nature' could not come into being. The proletariat continued to be wage slaves. So what did they gain by the Marxist revolution - a rise in their incomes? But so have they in the capitalist countries like the U.S., West Germany and Japan, substantially more than in Soviet Russia, Eastern Europe and China, although not as much as those of the bourgeoisie. Nearly all the lessons to be drawn from the socialist experience - economic inefficiency, bureaucracy, hierarchy, despotism, and frustration of grass-roots initiative - are negative.<sup>63</sup> Thus, considered against the background of what socialism visualized, the results are no less than frustrating.

#### **2.2.4 The Complexities of Reform**

As a result of all these negative indicators, socialist regimes have been overthrown all over Eastern Europe. Only in China has the regime been able to survive the wrath of the masses so far, but by means of repression. Even in the Soviet Union, the leadership has been forced by circumstances to accept the vital need for political and economic reform - *glasnost* (openness) and *perestroika*.<sup>64</sup>

The problem, however, is that nobody is yet clear about the extent of restructuring necessary to enable socialist countries to realize their goals. It is being argued that the remedy lies in decentralization and reintroduction of private property and market mechanism into the socialist economies. While this is no doubt necessary, a number of issues closely related to this subject have not yet been clarified by both *glasnost* and *perestroika*. These are: the extent of decentralization, competition, price reforms, privatization and property rights that a socialist economy is willing to tolerate without changing its identity totally. While half-baked reforms and piecemeal changes may be ineffective, bold moves in the direction of capitalism would, given the absence of

background conditions, only aggravate the existing socio-economic iniquities and lead to a permanent burial of the original *raison d'être* of socialism.

The glaring question hence remains whether the patching to socialism certain elements of capitalism, which has itself failed, can bring about the kind of revolutionary restructuring that is necessary to overcome the prevailing economic problems and social unrest and to realize the professed goals of socialism. Unfortunately, the entire debate about restructuring the socialist economies in both the capitalist and the socialist intellectual circles reflects a lack of awareness of the dire need for a change in the socialist worldview. The role of moral dimension in motivation and socio-economic restructuring does not even get a stray mention, as if it carries absolutely no importance.

It is not realized that if centralized decision-making and lack of private property and market-determined prices were the only factors responsible for shortages of need-satisfying goods and services in the socialist countries, the capitalist countries would certainly have been able to realize their goals. Needs cannot however be satisfied without an immensely larger allocation of resources for this purpose. The essential counterpart of increased allocation for need satisfaction is a substantially reduced allocation for some other purposes - defence, space programmes, heavy industries, prestige symbols, luxuries and privileges of the elite, and numerous other economic sectors and geographical areas having an 'excessive' allocation of resources in the past.

This re-allocation is not an easy task. It requires not only socially-agreed criteria but also a strong motivation on the part of the privileged and the rich individuals or geographical areas to sacrifice. Why will they do so in a secularist society with only a short, this-worldly frame of life? If, however, the 'unnecessary' spending which is in conflict with need satisfaction is not reduced, then where will the resources come from? Monetary expansion? This will lead to the same excessive claims on resources and the associated macroeconomic and external imbalances that capitalism and the welfare state are facing. The magnitude of the problem may be appreciated better if the need for substantially reducing the already existing unhealthy fiscal deficits is also borne in mind. These have risen in the Soviet Union from under 3 per cent of GDP in 1980-85 to about 7 per cent in 1987 and 14 per cent in 1988.<sup>65</sup> How will these be reduced

without hurting need-fulfillment, employment and growth? This crucial question remains unanswered. If heavy doses of borrowing are used to solve the problem, these countries may, after a few years, experience the same acute debt-servicing problems that the heavily-indebted developing countries are now facing.

Thus the socialist countries have an impossible task before them - that of restructuring their economies to fulfill needs without a filter mechanism of socially agreed values, that of reducing, budgetary deficits without generating unemployment and further reducing the rate of growth, and that of containing inflation in spite of introducing realistic prices in economies plagued by suppressed inflation. The introduction of realistic prices and exchange rates and the reduction of subsidies to lower the high budgetary deficits will mean the dismantling of the existing paternalistic system where retail prices bear no relationship with production or import costs, where cheap food, clothing and housing are at least theoretically assured, and where employment is supposed to be guaranteed. Realistic prices are bound to have an inflationary impact. If wages and pensions are not raised simultaneously, there will be a steep decline in the standard of living, particularly of the poor. This will create social unrest and political problems if *glasnost* is also to be maintained. If however, wages are raised with prices, then *perestroika* would not be effective. *Perestroika* would demand that wage increases not be guaranteed or uniform. They will have to be linked rather to labour productivity and enterprise revenues. If this is done, then some workers will be affected more adversely than others by price and wage changes. This will accentuate the differences in real incomes and contribute to greater income and wealth inequalities, thus leading to social unrest, as it did in China. In a market system where such changes occur in small doses every year, they may not be noticed as much as they will be in a system where the errors of decades are designed to be rectified in a few years. Hence moral regeneration and socio-economic restructuring are now more urgently needed by the privatizing command economies than any other economy in the world.

Moreover, the demand for increased efficiency cannot be meaningful unless the enterprises are also free to select the quality, quantity and sources of their inputs and also to hire and fire employees on the basis of their performance. The privilege

of a guaranteed market, which enterprises now enjoy, may also have to be withdrawn. This may increase the losses of many of them and lead to unemployment when they stop being paternalistic and fire employees in their quest for greater efficiency. Since the state enterprises are large, the problems resulting from the liquidation of loss-making enterprises will also be great, particularly unemployment. The socialist system is not geared to handle these problems resulting from the move toward the market system. Hence a programme of partial restoration of the market is a contradiction in terms, as long as the paternalistic goals continue. However, if these goals are abandoned along with central planning and collective ownership to realize greater efficiency, then what is it that is left of socialism to identify it as a distinct system?

Even the question of privatization is fraught with serious difficulties. Since all nationalized property now belongs essentially to the people, transfer of property rights through privatization needs to be brought about in a just manner. There seems to be no clear-cut programme for this as yet.

The programme which seems to be gaining currency is the auction of shares in state-owned industries and farms. However, before such an auction can take place, there has to be a realistic appraisal of value. Such an appraisal is a time-consuming and difficult job in the absence of market-related prices and returns. Without such appraisal, the risks would be too great for those not having insiders' knowledge. Moreover, the auction of shares has the disadvantage of giving an edge to those who had amassed wealth during the socialist period; they are the ones who will be able to buy the shares. Hence, those who were privileged without ownership rights will now add another plume to their hats - that of ownership. So what will happen to the proletariat in whose name socialism was brought about and in whose name it is now being dismantled?

However, if the property rights are to be passed on equitably to the people, then the perplexing question is about how this should be done - who gets a share in what and to what extent? If the workers are to be given shares in farms and enterprises in which they work, how about those who are either not working or working in less fertile areas or enterprises that are, or will soon become, bankrupt. If coupons are to be issued to everyone to purchase, then privatization may have to wait until the appraisal of all saleable enterprises and farms has been completed. But those who had amassed wealth in the past will again have an edge if they can use this wealth along with the coupons to purchase.

The social Darwinian weeding out process may also create problems. It has determined the make-up of socialist leadership over the last several decades and created a vested interest in the continuation of the existing situation. Officials of state enterprises may not be psychologically prepared to face the realities of market competition. The leadership may hence have to be ruthless to weed out inefficient managers. Since this may tend to create unrest and discontent, the leadership may try hard to pacify the vested interests to keep itself in power. Avoiding over-concentration of power, over-centralization of management, and diseconomies of scale, the major defects of socialism, will hence be an uphill task. 'Virtually everyone in the Soviet Union has an excellent reason to favour reform and an excellent reason to fear it.'<sup>66</sup> The power struggle that is bound to result between those who wish to cling to the existing privileges of power and the revisionists who cannot succeed unless such privileges are brought to an end, could not but reduce the speed of reform and also blunt its effectiveness through inevitable compromises.

### **3. The Islamic Alternative**

#### **3.1 The Worldview**

In contrast with the secularist worldview of the failed systems, the Islamic worldview is a balanced synthesis of both the material and the spiritual dimensions of life.<sup>67</sup> The synthesis reflects the belief that human beings cannot realize real well-being - well-being that would lead to their physical comfort as well as their mental happiness and tranquillity - until they have attained a balanced satisfaction of both the

material and the spiritual needs of human personality. An undue emphasis on one at the expense of the other is bound to create misery in the long run. Islam also takes the position that it is not possible to utilize resources efficiently and equitably even in a material sense until a moral dimension is injected into all aspects of human activity, including the decisions taken in the market place and corporate boardrooms or the politburo and the Gosplan, and until the economy is restructured in accordance with the dictates of goal realization and moral values. Even the imbalances and instability cannot be minimized, crime, strife and tensions cannot be reduced, and the different symptoms of anomie cannot be overcome.

The Islamic economic system has its roots in the *Sharī'ah*, which is based on belief in the One God, Who is the Creator of this universe and everything in it.<sup>68</sup> Human beings are His vicegerents and brothers unto each other. They are all accountable to Him for their life in this world, which is infinitesimally small compared with the Hereafter, their ultimate abode. The resources provided by Him are a trust and must be utilized in accordance with the terms of the trust.<sup>69</sup> These terms are defined by the values given by Him through His prophets, the last of whom was Muhammad, may the peace and blessings of God be on them all. These values place a considerable emphasis on socio-economic justice without which the concept of brotherhood would remain meaningless.<sup>70</sup> Socio-economic justice cannot however be meaningfully realized unless all the resources at the disposal of human beings are utilized efficiently and equitably to fulfil the needs of all and to bring about an equitable distribution of income and wealth. The Islamic economic system thus derives its goals as well as its strategy from the Islamic worldview, hence removing the possibility of a conflict between the two.<sup>71</sup>

### **3.2 The Strategy: Main Ingredients**

Islam does not however depend merely on this built-in harmony between its goals and worldview for designing an effective strategy. It also specifies certain essential ingredients of the strategy and puts behind them the full force of its moral sanction to bring about the kind of socio-economic and financial restructuring necessary for goal realization.

The Islamic strategy consists of a set of four indispensable and mutually-reinforcing ingredients. These are:

- a) a morally-based filter mechanism;
- b) strong motivating system to induce the individual to render his best in his own interest as well as in the interest of society;
- c) socio-economic and financial restructuring with the objective of realizing the desired goals in spite of scarce resources; and
- d) a positive and strong goal-oriented role for the government.

It is important to see how these four elements of the Islamic strategy can help bringing about the kind of allocation and distribution that goal actualization demands.

### **3.2.1 The Filter Mechanism**

The use of merely the price system as a filter mechanism frustrates, as already discussed, the realization of socio-economic justice unless the background conditions are fulfilled. The unhindered individual preferences, reinforced by value-free advertising, create unlimited wants, while the highly skewed income distribution and access to credit enables the rich to transfer scarce sources for the satisfaction of their unnecessary wants. This does not only squeeze the resources available for need satisfaction but also widens the savings-investment and export-import gaps and worsens the macroeconomic and external imbalances. Reliance on merely the price mechanism as a filtering device may help restore, though not necessarily, an equilibrium between demand and supply. If it does succeed, it does so primarily at the expense of the poor, who are unable to fulfill their needs at the resulting higher prices from the limited means they have at their disposal. Their well-being thus suffers.

Replacement of the decentralized filter mechanism of the market system by planning and state control makes the position worse. It makes the system despotic without introducing any improvement in goal realization. Centralizing control over the allocation of resources in the hands of a bureaucracy, which does not have effective way of getting information promptly about consumer preferences and producer costs, makes the decision-making process cumbersome, slow and inefficient. The



bureaucracy does not even have the socially-agreed values or a motivating system to ensure the well-being of all. The only criterion it has for allocation of resources is its own personal judgment which, without the help of both socially-agreed values and market signals, cannot ensure an allocation of resources that takes into account the relative scarcity of resources or the relative urgency of need satisfaction. Moreover, the powerful position of its members gives them all the leverage they need to serve their vested interest. The experience of centrally-planned economies has clearly shown that the resultant allocation and distribution of resources is neither efficient nor equitable.

The best strategy for injecting equity into the allocation of resources is hence not the removal of the decentralized decision-making process of the market. The decentralized system democratizes decision-making by enabling all individuals (consumers as well as producers) to participate. It also introduces greater efficiency by enabling prompt decision-making in response to changing circumstances. It would rather be better to complement the price mechanism by some other device that would eliminate or at least minimize unnecessary claims on resources - claims that lead to imbalances and serve as an obstacle in the way of need fulfillment.

This Islam does by introducing another filter. Allocation of resources is to be brought about by a double layer of filters. The first filter attacks the problem of unlimited wants at the very source - the inner consciousness of individuals - by changing the individual's preference scale in keeping with the demands of both efficiency and equity. Islam makes it incumbent upon all Muslims to pass their potential claims on resources through the filter of Islamic values so that many of them are eliminated at the source before they are exposed to the second filter of market prices.

The moral filter does not permit material possessions and want satisfaction to become ends in themselves. Satisfaction remains a function of need fulfillment. Self-display and vying with each other do not remain an admissible pattern of behaviour.<sup>72</sup> If claims on resources are then passed through the second filter of market prices, unnecessary claims can be more effectively eliminated or minimized. If the banking system is also made to play a complementary role, it

does not remain possible for the productive machinery of the economy to get directly or indirectly moved toward the satisfaction of a maximum amount of wants. The influence that wealth and power are able to exercise in the allocation and distribution of resources is thus substantially reduced. By thus confining claims on resources to the limits of need fulfillment, it becomes possible not only to minimize imbalances but also to use resources both efficiently and effectively.

One of the basic issues of every society, however, is, who is capable of providing such a filter mechanism? Must a moral code have a Divine Origin and must it be backed by belief in accountability before God? The Islamic view, as that of other major religions, is that Divine sanction and belief in life-after-death are both necessary. The reasons are not difficult to understand.

Firstly, the Divine sanction makes the rules of behaviour absolute and beyond dispute. Without the Divine sanction, they become the subject of personal judgment and dispute as happened in the West after its secularization, until their value came to be questioned altogether.<sup>73</sup> After their extensive but deep study of various civilizations, the Durants have drawn a very important lesson from history that: 'There is no significant example in history, before our time, of a society successfully maintaining moral life without the aid of religion.'<sup>74</sup>

Secondly, who among human beings could be absolutely impartial and totally committed to the well-being of all? If human beings were to try to develop these norms themselves, there would be a natural tendency on their part to frame norms that are skewed in favour of the powerful and the vested interests and not capable of serving the well-being of all. Even the slightest doubt about impartiality would negate the chances of a consensus.

Thirdly, human beings do not have the knowledge to assess the effects of their actions on other human beings, especially those more remotely affected by them. For this, if for no other reason, they need a well-meaning and knowledgeable outsider to provide them with rules of behaviour that can save others from the adverse effect of their actions.

Fourthly, the Supreme Being Who has created human beings is alone capable of understanding fully their nature, their needs, their strengths and their

weaknesses and of serving as the Sole Guide and the Only Source of all values. In His Infinite Kindness, He has not left human beings to grope in darkness; He has provided the needed Guidance through a chain of prophets starting from Adam himself - Guidance that can ensure the well-being of all.

Within the context of this logical framework, Pareto optimality is inconceivable. Pareto optimality can be in harmony with only that system which glorifies individualism and self-interest and sanctifies the status quo. It is no doubt in conflict with Islam which attaches primary importance to social responsibility and well-being of all. Values define the terms of reference for all human beings. They have all to act in conformity with these values to actualize the desired goals. Collective value judgments are accordingly indispensable and any attempt to refrain from making such value judgments is bound to create confusion and chaos and frustrate the realization of universal well-being.

### **3.2.2 Right Motivation**

Efficiency and equity cannot be realized by merely having a proper filter mechanism. It is also necessary to motivate individuals to act accordingly. Capitalism assumes that self-interest will induce an individual to maximize efficiency while competition will serve as a constraint on his self-interest and help safeguard social interest. A harmony will thus be brought about by the market system between self-interest and social interest. Socialism did not agree. It did not trust the individual and assumed that the serving of self-interest by him would necessarily hurt the social interest. Therefore, it condemned private property and serving of self-interest and established strict state control over the allocation and distribution of resources to safeguard social interest.

Serving of self-interest by individuals is not necessarily bad. It is rather necessary for human development and an economic system cannot be successful in realizing efficiency unless it allows individuals to serve their self-interest. Serving of self-interest becomes socially destructive only if it crosses certain limits and individuals are not willing to do things that need to be done for creating a society which has brotherhood and socio-economic justice as its central objectives. However, while a rational individual would in any society be normally willing to

render his best in his self-interest, if he is able to get an adequate reward for his contribution, the question is: what would motivate him to work in the interest of society? Why should a consumer hold his claims on resources 'within the limits of humanity' and make sacrifices for others, and why should a businessman not try to stifle competition or use questionable means to enrich himself? This is where the concepts of accountability before God and life-after-death become indispensable.

Self-interest restricted to the confines of this finite world is bound to cultivate the evils of greed, unscrupulousness, and disregard for the interest of others. 'Whenever they get a chance', observes *The Economist*, rational economic agents try to benefit themselves at the expense of everybody else. So, for many kinds of spillover a market solution is frustrated by the very force that usually makes markets work'.<sup>75</sup> Self-interest cannot motivate individuals in a secularist, this-worldly society to fulfill their social obligations conscientiously except where doing so contributes to their this-worldly benefit. Pareto optimality is hence the only logical behaviour norm for such a society, irrespective of whether it is capitalist or socialist. Pareto was not wrong within the this-worldly framework in which his mind worked, like that of all other secularists.

Capitalism thus does not have an effective mechanism to motivate an individual to work in the interest of society unless the interest of society is served automatically by the serving of self-interest. Since the two interests are not necessarily harmonious and since the background conditions are not satisfied, reliance on the price system alone has made capitalism inequitable. Socialism is even worse. By preventing the individual from serving his self-interest, it has deprived itself of a mechanism to motivate the individual to work efficiently. Moreover, its this-worldly perspective does not even provide the individual with a motivation to work in the social interest. Hence socialism has failed to realize both efficiency and equity.

If, however, the dimensions of accountability before an All-Powerful Being, from Whom nothing can be hidden (Qur'an, 5:3), and a life-after-death are introduced, another kind of rationality is created. These beliefs provide an entirely different perspective to individual and social thinking, attitudes and behaviour. They supply a powerful motivating force for socially-oriented action by giving self-interest an infinitely longer perspective. They imply that an individual's self-interest is not served only by improving his condition in this world but also in the Hereafter. Hence, if he is rational and aspires to serve his self-interest, he will not act merely for his short-run, this-worldly well-being, but will also try to ensure his long-run well-being by working for the welfare of others through a reduction in his wasteful and unnecessary consumption in spite of his financial ability to be profligate, and using a part of his income and wealth for helping others (through *zakat*, *sadaqat*, *awqaf*, and taxes). The resources which, are released by economizing can be diverted to investment, job creation, and increased production and distribution of need-fulfilling goods, thus serving the interest of the poor. Similarly, the belief that life in this world is infinitesimally small compared to that in the Hereafter can prevent a businessman from enriching himself through questionable means, thus helping others by not shrinking their frontiers of opportunities and depriving them of their independent means of living. These beliefs thus carry the potential to provide an effective mechanism to motivate an individual to respond to the questions of what, how, and for whom, in such a way that allocation and distribution take place in accordance with the dictates of general well-being.

While Islam provides a longer-run perspective to human action, it does not ask individuals to neglect their self-interest in this world. This would not have been practical. Any value system that does so cannot work. Islam in fact encourages an individual to satisfy all his essential needs to remain physically and mentally healthy and efficient to be able to perform his responsibilities towards God, himself and his society and to develop his total potential. There is no point in shunning 'the good things that God has provided' (Qur'an, 7:32). However, since resources are limited, it does not befit him, as vicegerent of God, to go to the extreme of becoming an economic man and ignoring the well-being of others. As Alec Nove has rightly remarked, 'Societies concerned only with profit will fall to pieces.'

Corruption in the literal and the figurative sense can flourish where the making of money becomes the primary aspiration, the dominant criterion of success.<sup>76</sup> Joseph Schumpeter also remarked that, ‘No social system can work ... in which everyone is supposed to be guided by nothing except his own short-run utilitarian interest.’<sup>77</sup> It is absolutely necessary to create a balance (*mizan*, in the terminology of the Qur’an, 55:7-9) between individual and social interests for ensuring social well-being and continued development of the human potential.

What Islam has done to create such a balance is to provide a spiritual and long-run dimension to self-interest. The individual must look after his interest in this world, which is infinitesimally short, as well as the Hereafter, which is eternal. While the interest in this world may be, though not necessarily, served by being selfish and unscrupulous, the interest in the Hereafter cannot be served except by fulfilling one’s obligations towards others, without resorting necessarily to self-denial. The belief in accountability before an All-Powerful and All-Knowing Being can thus play an important role in keeping self-interest within bounds and generating social welfare-oriented behaviour. State regulation, although necessary, cannot by itself perform this function because the chances of being detected by the state are not fool-proof and there are possibilities of escaping the adverse consequences of official prosecution through bribing or the use of one’s political leverage.

Thus, Islam recognizes, while socialism denies, the contribution that the serving of individual self-interest through profit and private property can make towards individual initiative, drive, efficiency and entrepreneurship. Islam, however, overcomes the evils of greed, unscrupulousness and disregard for the rights and needs of others, which the secularist and short-run, this-worldly perspective of both capitalism and socialism can promote. This it does through the internal self-regulating mechanism instilled in the inner consciousness of the human being himself, with its unrelenting emphasis on belief in accountability before God, human brotherhood and socio-economic justice. This structure of beliefs can provide a strong motivating force to prevent individuals from pursuing self-interest beyond the limits of social health and well-being.

Competition and market forces are no doubt indispensable for the valuable contribution they can make towards efficiency of the allocative machinery. But these must operate within the constraints of the filter mechanism of moral values if the realization of social goals is to be ensured. Only within these constraints will competition be 'healthy' and market forces 'humane'. Neither competition and market forces nor central planning and regimentation have the potential to instill in human beings the powerful motivating force for equitable use of scarce resources that the belief in accountability before God has. While in both the capitalist and the socialist systems, the powerful and vested interests have no mechanism instilled in their inner consciousness to prevent them from manipulating policies and resources to their undue advantage, or to regulate their spending in accordance with the dictates of social well-being, in the Islamic system, as in any other effective religious system, they would be strongly motivated to do so. If they do not they will be acting against their long-run self-interest.

### **3.2.3 Socio-Economic and Financial Restructuring**

Both the filter mechanism and the motivating system may become blunted if the social consumption pattern, government policies (particularly those related to taxation, expenditure, saving and investment, exchange rates, and trade and development), and financial intermediation are not geared to goal realization. Hence the first two ingredients of the strategy must be reinforced by a third ingredient - socio-economic and financial restructuring - to create a proper socio-economic and policy environment.<sup>78</sup> The absence of such restructuring would not only promote consumption, discourage saving and investment, and accentuate inequalities, but also exacerbate the existing macroeconomic and external imbalances through greater resort to deficit financing, credit expansion and external debt.

It would not be possible to attain such a thorough restructuring by means of random or *ad hoc* measures or by relying merely on the price mechanism. It would rather be necessary to take effective measures addressed to:

(a) Invigorating the human factor by motivating, and enabling him to perform consciously the tasks needed. to be performed not only in the interest of his own well-being but also that of his society;

(b) Reducing the existing concentration of wealth and ownership of means of production; and

(c) Reforming all social, economic and political institutions, particularly public finances and financial intermediation, in the light of Islamic teachings, to help minimize wasteful and unnecessary consumption and to promote investment for need-fulfillment, exports and increased employment and self-employment.

The human factor cannot be invigorated to perform its socio-economic obligations conscientiously merely by moral reform, even though this is indispensable. Moral reform must be reinforced by socio-economic justice, which it is not possible to actualize without enabling the poor to be more productive and to get a just reward for their contribution to output. This demands easier access to better education, training, and investment finance, and removal of all other sources of economic distortions, exploitation and iniquities.

It will not be possible to reduce the existing concentration of wealth without tilting the balance of government policies in favour of socio-economic justice. The power centres in society must be diluted by removing or substantially reforming policies that give an undue advantage to big landlords and large businesses. It is also necessary to place greater emphasis on agricultural and rural development in government policies, to implement land reforms, and to promote a broad-based ownership and control of corporations. Proliferation of small and micro enterprises in both rural and urban areas should help not only in weakening the power centres but also in promoting greater competition, and expanding employment and self-employment opportunities. The preferred goal should be to make income-earning opportunities available close to where people live to avoid hectic and unhealthy urbanization. Implementation of the Islamic institutions of *zakat*, *sadaqat*, *awqaf*, and inheritance is also indispensable.



To reduce consumption and raise savings, it is necessary to inculcate simple living in conformity with Islamic norms and to undermine the unhealthy influence of Western consumer culture and social customs and ceremonies. All these socio-economic goals cannot be realized merely by means of controls. Controls do not normally work. They accentuate corruption and frustrate grass-roots initiative. Socio-economic and institutional reform must generally replace the existing tendency of heavy dependence on controls. This is where the injection of a moral dimension in socio-economic policies becomes imperative.

To promote investment, government policies must be oriented toward freedom of enterprise within the constraints of Islamic values. The policy should be to remove red tape and to encourage and facilitate all economic activity that contributes to goal realization without violating Islamic values. Government taxation and expenditure policies should also be streamlined to promote saving and investment, to realize socio-economic justice, and to reduce unhealthy budgetary deficits.<sup>79</sup>

Since financial intermediation plays a crucial role in the allocation and distribution of resources, the needed economic restructuring for greater efficiency and equity may not materialize if the conventional financial system continues undisturbed. It must be replaced by a system of financial intermediation based on profit-and-loss sharing, which would force financiers to give greater weight to the ultimate use of credit and the strength of the project and thus make a greater contribution to goal realization. Even the entrepreneurial talent among the poor would thus be harnessed by reducing the weight of collateral in financing and raising that of the nature of the project and its profitability and contribution to society.<sup>80</sup>

Some important elements of the needed economic and financial restructuring constitute an integral part of a Muslim's beliefs. His fate in the Hereafter depends on faithful compliance with these. The other elements are or can be logically deduced from Islamic values. The motivation to comply would thus be stronger. The restructuring in an Islamic economy is, hence, likely to be more successful than any counterpart in a secularist environment or a religious system not concerned with socio-economic restructuring. Once such restructuring has been

effectively enforced, the resultant system should be different in a revolutionary way from both the market system and socialism.

### **3.2.3 Role of the State**

Such a comprehensive restructuring designed to actualize the desired goals and to minimize the existing imbalances may not be possible without the playing of an active role in the economy by the state.<sup>81</sup> This is because even in a morally charged environment it is possible for individuals to be simply unaware of the urgent and unsatisfied needs of others or to be oblivious to the problems of scarcity and to social priorities in resource allocation. Under such conditions, moral uplift and the price system, no matter how indispensable, cannot be sufficient to realize the kind of restructuring needed for equity as well as efficiency in the allocation and distribution of resources.

.. The role of the state in an Islamic economy is not, however, in the nature of an intervention, which is an unsavoury term and smacks of an underlying commitment to *laissez-faire* capitalism. It is also not in the nature of the secularist welfare state which, through its anathema to value judgments, accentuates claims on resources and leads to macroeconomic imbalances. It is also not in the nature of collectivization and regimentation which suppress freedom and sap individual initiative and enterprise. It is, rather, a positive role - a moral obligation to perform a mission in compliance with the Divinely-bestowed filter mechanism - to keep the economic train on the agreed track and to prevent its diversion by powerful vested interests. The greater the motivation people have in implementing Islamic values and the more effective socio-economic institutions and financial intermediation are in creating a just equilibrium between resources and claims and in realizing desired goals, the lesser will be the role that the state may be required to play in the economy.

While Islam recognizes individual freedom and the role of price mechanism in promoting efficiency, it does not give any sanctity to market forces. The blind operation of market forces does not automatically reward socially productive effort, curb exploitation or help the weak and the needy. It is, therefore, the responsibility of the state to ensure the realization of desired goals. The Islamic

state would not resort to the use of force to realize its goals, nor would it depend on owning and operating a substantial part of the economy. The abolition of interest would not permit this. It would rather try to motivate and help the private sector play its role effectively within the constraints of social well-being. For this it would have to rely on raising the moral consciousness of the people, accelerating social, institutional and political reform, and providing incentives and facilities. It would have to create a proper framework for the interaction of human beings, values and institutions for the realization of goals.

The state could do this more effectively through a long-run strategic policy plan which would enable it to take a realistic account of all available physical and human resources and to establish, in the light of this, a set of well-defined priorities. This will help provide a clear direction to government policies and expenditure programmes and initiate effective measures for setting in motion the required structural and institutional reforms to enable the government and the private sector to co-operate in using scarce resources with optimum efficiency and equity for accelerated attainment of socially-desired goals.

### **3.3 Epilogue**

The Islamic strategy thus humanizes the operation of market forces and realizes the advantages of the market system without being encumbered by its iniquities. This it does by creating a balanced synthesis of the spiritual and the material. The injection of a moral dimension into the inner core of human consciousness helps promote the peace of mind, which is indispensable for creating inner happiness but to which secularism does not even aspire. The Divine origin of goals and values makes them unquestionable, thus increasing the chances of reaching social consensus on priorities in resource use. Recognition of the important role that private enterprise can play in individual initiative and drive makes it possible to realize greater efficiency. Awareness of the trust nature of resources and the unavoidable accountability before God makes it possible to motivate the individual to give a greater weight to social well-being in his decisions and to eliminate, or at least minimize, wasteful and conspicuous consumption even before the demand for this gets an expression in the market place. If the price system with its decentralized decision-making then takes over, the allocation of resources can be efficient and equitable. The use of a double layer of filters (moral values along

with the price mechanism) should help not only reduce aggregate claims on resources but also make possible the allocation of a greater proportion of resources for need satisfaction and productive investment. This should help accelerate growth, contain inflationary pressures, promote exports, and minimize the external imbalances and the currency depreciation that are pestering most developing countries. If these are further reinforced by the various Islamic redistribution schemes, there will be a greater chance of ensuring the well-being of the poor and low-income families in spite of the resource constraint.<sup>82</sup> The resort to Islamic financial intermediation should further boost the realization of both efficiency and equity.

However, even a moral system may tend to be ineffective if it is not accompanied by socio-economic restructuring. But socio-economic restructuring could be introduced more effectively if the moral dimension is injected into the society and the government also plays an effective role. The government could do this more effectively by resorting to strategic policy planning, which would enable it to assess the economy's resources and needs and determine the extent of changes needed in consumption and investment patterns of both the private and the public sectors. Social, institutional and structural reforms could then be designed to create a proper climate for realizing need-fulfillment and equitable distribution of income and wealth.

Egalitarian policies, if they are followed within the perspective of the Islamic motivating system, are not likely to meet with the same kind of resistance from the rich that they would in a socio-economic system committed to Pareto optimality. They should also help dampen socio-economic unrest and political instability and contribute to higher growth. A better fed, healthy, and properly educated and motivated population cannot but improve the quality of the work force in countries where serious consumption deficiencies and health and educational impairments are holding down the quality of work. Greater social and economic equality along with need fulfillment and moral uplift should also help reduce crime and social tensions.

The inability of the prevailing economic systems to provide even the material ingredients of human well-being, and the fruitlessness of introducing

cosmetic changes in these systems or of fine-tuning them, decidedly point towards the need for a new economic system. The economic system of Islam has the potential of responding effectively to this need. It is capable of providing not only the material ingredients of human well-being but also the spiritual ingredients without which it is not possible to realize inner happiness and tranquility. However, unless the Muslim countries themselves implement the Islamic system and practically demonstrate its great potential, it cannot serve as an example which other countries, and particularly developing countries, may follow.

O you who believe! Respond to God and His Prophet when they call you towards that which will give you life.(Qur'an, 8:24)

O you who believe! Why do you say something which you do not act upon. It is most deplorable in the sight of God that you say what you do not do.(Qur'an, 61:2-3)

## Notes and References

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2. Arthur Lovejoy, *The Great Chain of Being* (New York: Harper & Brothers, 1960), p. 7.
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4. Edwin A. Burt, *The Metaphysical Foundations of Modern Science* (Garden City, N.Y.: Doubleday, 1955), p. 27.
5. Bertrand Russell, *A History of Western Philosophy* (New York: Simon & Schuster, 1945), p. 775.
6. Adam Smith, 'Invisible Hand,' in L. S. Stepelevich, ed., *The Capitalist Reader* (New York: Arlington House Publishers, 1977), p. 20. See also, Wilhelm Roepke, 'Ordered Anarchy', *ibid.*, p. '32.
7. Few economists would now be willing to support this claim about equitable distribution. It is however a logical outcome of the assumed symmetry between public and private interests and was widely held by economists, like J. B. Clark, who believed that factor incomes in the real world closely approximated the marginal product and its value (See G. Stigler, *Production and Distribution Theories: The Formative Period*, New York: Macmillan, 1941). This view hence provided the rationale for the much-cherished government non-intervention principle.
8. Vance Packard has expounded this phenomenon at the popular level in a series of books. Typical of these is *The Hidden Persuaders* (Harlow, Essex, U.K.:

Longman, 1957), an expose of the wiles of Madison Avenue. See also Charles Lindholm, *Politics and Markets*, p. 79. A number of expressions are used by economists to describe the phenomenon of creating unwarranted wants. These include the 'bandwagon' effect, the 'snob' effect, and the 'Veblen' effect. For representative definitions of these, see Harvey Leibenstein, *Beyond Economic Man* (Cambridge, Mass: Harvard University Press, 1976), pp. 51-2.

9. Arthur Okun, *Equality and Efficiency: The Big Trade-Off* (Washington, D.C.: Brookings Institution, 1975), p. 11.
10. R. H. Tawney, *The Acquisitive Society* (New York: Harcourt Brace, 1948), p. 12
11. See Andrew Hacker, et al., 'Corporation, Business,' *The New Encyclopedia Britannica*, 15th edition (1973-74), vol. 5, p. 182.
12. See Edward S. Mason, ed., *The Corporation in Modern Society* (Cambridge, Mass.: Harvard University Press, 1980), for a useful anthology on the subject.
13. Quoted by David Owen, 'Go Broke, Young Man,' *Financial Times*, 31 January 1987, p. I. 14. Greenberg, *op. cit.*, p. 247.
15. Robert Sheehan, 'Proprietors in the World of Big Business,' *Fortune*, 15 June 1967, p. 179.
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17. C. Wright Mills, *The Power Elite* (New York: Oxford University Press, 1956), p. 116. 18. See Kolko, *op. cit.*, pp. 68 and 127.
19. Edward S. Mason, 'Corporation', *International Encyclopedia of Social Sciences*, vol. 3, p. 401.
20. David Reisman, *Galbraith and American Capitalism* (London: Macmillan, 1980), pp. 58-68.

21. Hacker, et al., *op. cit.*, p. 185. 22. *Ibid.*
23. Greenberg, *op. cit.*, p. 40.
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25. Adolf A. Berle, Jr., *The Twentieth Century Capitalist Revolution* (New York: Harcourt, 1954), p. 39.
26. Galbraith, *The New Industrial State*, (New York: American Library, 1972), p. xiv.
27. See Elizabeth Jay and Richard Jay, *Critics of Capitalism: Victorian Reactions to Political Economy* (Cambridge: Cambridge University Press, 1986), pp. 15-16.
28. See Lawrence R. Klein, *The Keynesian Revolution* (New York: Macmillan, 1954), Chapter 7 (pp. 165-87).
29. I. Adelman and C. T. Morris, *Economic Growth and Social Equity in Developing Countries* (Stanford, California: Stanford University Press, 1973), p. 189.
30. Bernard Cazes, 'Welfare State: A Double Bind,' in OECD, *The Welfare State in Crisis* (Paris: OECD, 1981), p. 151.
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32. Savings have fallen in all industrial countries from an average of 17.5 per cent of national disposable income during 1960-74 to 10.7 per cent during 1980-87. They have fallen more steeply in the U.S. and France, going down over this period from 10.5 and 19.4 per cent to less than half that level - 4.2 per cent and 8.6 per cent. In West Germany and the U.K. they have dropped from 19.6 and 10.9 per cent to 11.0 per cent and 6.3 per cent. Even in Japan, the source of capital for many Western countries, they have declined from 26.4 per cent to 20.4 per cent (Bank for International Settlements, *Fifty-Ninth Annual Report* for the period 1988/89, Basle, June 1989, table on 'Saving and Investment: a longer-term comparison,' p. 32.



33. Paul A. Samuelson, *Economics*, (New York: McGraw Hill, 1980) p. 591.
34. John K. Galbraith, *The Affluent Society* (Boston: Houghton Mifflin, 1958); see also, Harry K. Girvetz, 'Welfare State,' *International Encyclopedia of the Social Sciences*, vol. 16, pp. 519-20.
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36. See M. U. Chapra, *Towards a Just Monetary System* (Leicester, U.K.: The Islamic Foundation, 1985), p: 140.
- 37.. E. S. Mishan, *Cost Benefit Analysis: An Introduction* (New York: Praeger, 1971), p. 205.
38. Galbraith, *Economics and the Public Purpose*, *op. cit.*, pp. 186-7.
39. *Ibid*, p. 297. The term planning system is used by Galbraith in sharp contrast with the classical model of a perfectly competitive market. It refers to a market dominated by a few large oligopolistic corporations, each dominating a significant part of the market and able to exercise control over its prices and products. The consumer plays a relatively passive role by responding to persuasive advertising. (*ibid.*; pp. 11-50).
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