

ISLAMIC VIEW OF CAPITALISM

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The Challenge

The challenge that mankind faces is to ensure the well-being of all people in spite of the scarcity of resources at its disposal relative to the claims on them. The success of any economic system, irrespective of whether it is capitalism or some other system, should therefore be measured against its ability to help meet this challenge. The system will be able to succeed in this task only if it can help ensure the most 'efficient' and the most 'equitable' use of scarce resources for actualizing certain goals that are generally considered necessary for realizing the well-being of all. These goals may be classified, for the sake of convenience, into economic and social, even though it is sometimes difficult to distinguish them clearly from each other.

Some of the most important economic goals generally recognized by the Economics profession as necessary for promoting human well-being are: optimum non-inflationary rate of growth, elimination of poverty and need fulfillment of all, full employment, equitable distribution of income and wealth, and economic and financial stability. Some of the most important social goals which are also considered to be equally, if not more, necessary for human well-being are: family and social solidarity, and freedom from tensions, crime and anomie. Even though these social goals are desired in their own right because of their impact on individual happiness and social harmony, they are also desired because of their impact on economic performance. All aspects of human society are, according to Ibn Khaldun (d. 808AH/1406AC), interrelated and the realization of even economic goals may be difficult to sustain in the long-term without the simultaneous realization of social goals (Ibn Khaldun, *Muqaddimah*).¹

¹ Several different editions of the *Muqaddimah* are now available in Arabic. The one I have referred to in this paper is the one published in Cairo by al-Maktabah al-Tijāryyah al-Kubrā without any indication of the year of publication. It has the advantage of showing all vowel marks, which makes the reading relatively easier. The *Muqaddimah* was translated into English in three volumes by Franz Rosenthal. Its first edition was published in 1958 and the second edition in 1967. Selections from the *Muqaddimah* by Charles Issawi were published in 1950

However, the stark reality is that, while capitalism has generally performed well in terms of promoting economic efficiency and growth, and contributed to the material prosperity of societies which have adopted it, its performance in realizing other socio-economic goals has been generally poor. It has failed to enable these societies to fulfil the needs of all individuals and to realize full employment, equitable distribution of income and wealth, and stability in the financial markets. This failure is made all the more conspicuous by a rise in all the symptoms of anomie, such as crime, tensions, divorce, juvenile delinquency, and mental illness, all indicating lack of inner happiness in the life of individuals.

The Strategy and its Logic

This raises the question of what is the reason behind this failure. The answer lies perhaps in the strategy pursued by capitalism. This leads us to the related question of what is it that is peculiar about the strategy of capitalism that has led to the failure? Could it be its recognition of private ownership of property and freedom of enterprise? This cannot be the answer because these are also embedded in the value system of other societies, including Islamic, and have proved to be indispensable for promoting efficiency and growth. If private property is not necessarily the cause of failures, then, could it be in the lack of recognition of a role for the state in the economy? This is also not the case because, while capitalism stood for *laissez faire*, or government non-intervention, during a long phase of its history, it no longer upholds this extremist view. The misery of the working classes, rising inequalities of income and wealth, the Great Depression of the 1930s, and the Keynesian revolution as well as the socialist onslaught have all led to the recognition of a role for the state in the economy. However, though the stagflation of the 1970s and the rational expectations theory have led to a recognition of the limitations of government intervention.

So what is peculiar about the strategy of capitalism which could be considered as the cause of its failure? It is essentially its secular worldview. Capitalism has been greatly influenced by the Enlightenment worldview, which arose in the 17th century as “a repudiation, and in some respects an antithesis, of much of Christian belief” (Brinton, 1967, p.521). This gave rise to positivism, which refused to accept any idea which could not be established by observation and experiment, and led, in turn, to a weakening of all metaphysical precepts, including faith in God, revelation, human

brotherhood, life after death, and all other religious beliefs, and created an anathema to value judgements.

Utilitarianism took the place of moral values and 'right' and 'wrong', 'desirable' and 'undesirable', and 'just' and 'unjust' began to be determined by the hedonist criteria of 'pleasure' and 'pain'. This provided sanctity to materialism and social Darwinism in the Capitalist worldview and gave rise to the concept of 'rational economic man' whose main objective in life was to serve his self-interest and maximize his wealth and want satisfaction. The serving of self-interest became "the moral equivalent of the force of gravity in nature" (Myers, 1983, p.4). Within this framework, society came to be conceptualized as a mere collection of individuals united through ties of self-interest. It was not necessary to worry about 'social interest' because the 'invisible' hand of market forces would automatically protect it by means of competition. Competition will keep self-interest under constraint and thereby automatically serve social interest as an "unintended consequence of uncoordinated selfishness" (Rosenberg, 1992, p. 219; see also Blackhouse, 1994, p.13). There is, therefore, no need for the intervention of either the government or the society.

The crucial feature in the entire logic of capitalism was, thus, its secularist worldview, which led to an undue emphasis on the serving of self-interest, a neglect of the role of moral values in the realization of socio-economic goals, and the claimed symmetry between public and private interests. It began to be argued that the free interaction of 'sovereign' consumers trying to maximize their utility, and passive producers trying to maximize their profit, will, under perfectly competitive market conditions, determine the market clearing prices for goods and services. These prices will serve as an impartial and 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 will also automatically determine the transfer of resources from one use to another, thus contributing to their most efficient utilization without anyone's conscious effort or intervention.

Since the resultant configuration of goods and services is a reflection of consumer preferences, it is the most 'efficient'; it is not possible to improve upon it. Since this configuration also determines the incomes earned by the respective factors

of production on the basis of their contribution to output and revenue, the resultant income distribution is also 'equitable'.² At the point of equilibrium, consumer satisfactions (utilities) are maximized, supplier costs are minimized, and factor earnings (including wages and profits) are maximized.

Capitalism, it was thus concluded, helped determine not only the most 'efficient' use of resources but also the most 'equitable' distribution of income in a rational and impartial manner without value judgements or government intervention. It, thus, automatically brought about harmony between private and public interests. Questions about whether this configuration satisfied basic human needs and whether the distribution was equitable were improper because such questions cannot be answered without collective value judgements which, unlike market clearing prices, cannot be established impartially. Questions about differentials in wealth holdings were similarly improper because the wealth of individuals represented the savings resulting from the market value of their contributions to output and their abstinence from consumption. Hence there was no need for government intervention except to the extent to which it was necessary to ensure competition and orderly markets and to offset market failure in the supply of public goods.

But history and experience have belied the claimed symmetry between private and social interest. The system failed to realize equity. The 'invisible hand' of market forces, guided primarily by 'self-interest' led, in the words of Dalton, to “an inhumane, squalid and unjust society of rampant commercialism, social division, and conflict between employer and employee, landlord and tenant, and ruler and ruled.” (Dalton, 1974, p.68). It also yielded another sour fruit in the form of what Fukuyama(1997) calls “the great disruption”, referring thereby to the breakdown of the family.

² There is no doubt that few economists would now be willing to support this view. 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 felt that factor incomes in the real world closely approximated the marginal product and its value (See Stigler, (1941). It therefore provided the rationale for the much-cherished government non-intervention principle. Friedman also argues very clearly that: “However we might wish it otherwise, it simply is not possible to use prices to transmit information and provide an incentive to act on that information without using prices also to affect, even if not completely determine, the distribution of income” (1980, p.23).

Flaws in the Logic

The primary reason for these sour fruits was the existence of a number of flaws in the logic of capitalism. One of these was that every competitive equilibrium was considered to be Pareto optimum. It was not possible to make anyone better off without making someone else worse off. The terms 'efficiency' and 'equity', as defined within the framework discussed above, did not have a direct relationship with the objectives of removing poverty, fulfilling needs, and reducing inequalities of income and wealth or of realizing the other socio-economic goals. It was assumed that these objectives will also be realized as an indirect result of 'efficiency' and 'equity' brought about by the competitive equilibrium. Any outside intervention to change the status quo would necessarily lead to results which were less 'efficient' and less 'equitable'. The only acceptable way to change the status quo would be within the framework of Pareto optimality - to make some people 'better off' without making anyone 'worse off'. This was the only way to avoid a sacrifice on the part of some for the well-being of others. However, since there was no policy which would not make at least some people worse off, Pareto optimum virtually granted a veto power to anyone opposed to change. It, thus, led to near-paralysis of policy making, "to inaction, to non-choice, to drifting" (Solo, 1981, p.38; see also Amartya Sen, 1987, p.32).

Another flaw in the logic of capitalism was that it ignored the role of institutions other than the market in the realization of humanitarian goals. It was not appreciated that the market was only one of a number of institutions needed for organizing economic and social life and realizing human well-being. Some of the most important other institutions were the family, the society, and the state. The family is perhaps the most important of these because it provides the human input for the market, the society, and the state. It is the primary breeding place and training ground for all individuals. It is here that a substantial part of individual tastes and preferences, personalities, and behavior patterns get formed. The family's health and solidarity is, hence, of crucial importance. If the family disintegrates, would it be possible to provide the future generation with the kind of upbringing that it needs? If the quality of upbringing goes down, will it then be possible for a society to sustain its development and supremacy for long in the economic, technological, or military

fields? Because economic growth is also one of the objectives of capitalism, would it then be realistic on its part to ignore the integrity and stability of the family?

The Missing Links

If the market, the family, the society, and the state all have a role to play in human well-being, then the question is how to make them play their roles in a manner that complements and does not hinder the effective performance of their role by others? Although the market may operate efficiently if every individual tries to serve his or her self-interest, would it also be possible for families, the society, and the state to operate effectively and harmoniously if everyone were to behave in the same self-interested manner?

These are not new questions. They have been addressed by social philosophers for centuries. The majority seems to hold the view that the serving of self-interest is only one of the motivating forces in human society, and maximization of wealth and consumption is only one of the goals. The social goals stated above are of equal, if not greater, importance. Individuals in any society cannot be glued together and social solidarity so indispensable for promoting mutual cooperation cannot be attained without the realization of social goals. This necessitates rules of behaviour, which Institutional Economics calls institutions and religions call moral values. These values or rules of behaviour are, however, meaningless unless they get enforced. Their enforcement entails sacrifice on the part of those who are adversely affected. Would it be possible to enforce these rules if every individual sets the serving of self-interest and the maximization of wealth and consumption as his/her primary goal, and is not willing to sacrifice his/her interest for realizing social well-being?

Sacrifice is of particularly great importance in the case of the family and the society. Experience shows that the more the parents adopt an attitude of mutual sacrifice and cooperation, the more they will be attached to each other and greater harmony and stability there is likely to be in the family. The upbringing of children also requires a substantial degree of mutual cooperation and sacrifice of self-interest on the part of parents. Similarly social harmony may also require members to cooperate with each other and to sacrifice for the common good and the well-being of the poor and the vulnerable. Even in the case of the market and the state, sacrifice

may not be avoidable. In spite of competition, which helps safeguard social interest, it may be possible for operators in the market to make unjustified gains by cheating and obstructing competition in a manner that may be difficult to detect. Similarly, although democracy, public accountability, and a free press do help in protecting the public interest, it may nevertheless be possible for government officials to use their authority for personal benefit at the expense of the taxpayer.

Therefore, there has to be some motivating force that prevents individuals from wrongdoing even when it is possible for them to get away unscathed. Government coercive power has proved to be an effective motivating force. However, if this were the only force in human society to prevent wrongdoing, it would lead to a totalitarian state and the costs of enforcement would also tend to be very high. Is it possible to supplement competition, public accountability, and government coercive power by some other motivating force that might induce members of society to abide willingly by agreed values or rules of behavior and to fulfil their contracts and social obligations faithfully even when this involves a sacrifice of self-interest?

The Question of Motivation

This brings us to the question of why should any person sacrifice his or her self-interest to serve social interest in the market place, the family, the society, or the government. If capitalism concentrates only on self-interest and has no place for a motivating force other than self-interest, then it may not be able to answer this question. If maximizing wealth and consumption is the only goal in the life of an individual, then there is no need to make any sacrifice for others. Serving self-interest may be the best policy. The family may then suffer; the quality of the future generation may decline, and even the performance of the market and the government may ultimately be adversely affected.

The question, therefore, is how to motivate individuals to fulfil their contracts and other commitments honestly and to not undermine competition or resort to unfair means of earning even when it is possible for them to get away with it? This is a question that Islam and other major religions have tried to address by providing rules of behavior in the form of moral obligations of individuals towards other human beings, animals, and environment, and trying to motivate their followers to abide by

these rules even when doing so hurts their self-interest in this world. The motivation comes from belief in accountability for all our deeds in this world before a Just and All-Knowingly God Who sees everything and Who will reward and punish everyone according to his or her deeds. A person may be able to get away unscathed in this world for the injustices he has inflicted on others, but he cannot escape retribution from God in the Hereafter. Whether or not these religions have succeeded adequately in motivating their followers is a different matter. However, capitalism may not be able to ignore religious values and the associated motivating force if its goal is the realization of human well-being.

A society may have attained the pinnacle of glory in the material sense, but it may not be able to sustain it for long if the moral fiber of individuals and society is weakening, the family is disintegrating, the new generation is unable to get the kind of attention and upbringing that are necessary for an achieving civilization, and social tensions and anomie are rising. The economic and the social aspects of well-being are not, therefore, independent of each other. They are closely interrelated. Greater family harmony may help raise better individuals to operate in the market, and better social harmony may create a more conducive environment for effective government and accelerated development. If this is true, then the undue emphasis on serving self-interest and maximizing wealth and consumption may have to be toned down at least to some extent to serve social interest and optimize human well-being. Some uses of resources that serve self-interest and fit well into the hedonist framework may have to be reduced to fulfil the needs of all individuals in society and thereby promote family and social harmony.

The Mechanisms

This raises the question of how to bring about the allocation and distribution of resources in a way that helps realize all the socio-economic goals. There are three important mechanisms that determine the use of resources in any society or economic system. These are filtering, motivation, and socio-economic and political restructuring (Chapra, 1992, pp. 213-233).

Firstly, it is necessary to create an equilibrium between all the claims on resources and their supply. For this purpose, the claims need to be passed through a

filter. The filtering, however, needs to be done in a way that ensures the realization of goals. Three of the most important ways of filtering are central planning, market mechanism, and moral values (Chapra, 1992, pp. 71-112). Experience of socialist countries has shown that central planning has not been an effective mechanism for filtering even in the material sense, and almost all of them have abandoned it by now. However, capitalism has performed well with the help of market mechanism. Prices determined through the interaction of supply and demand in perfectly competitive markets help filter out the various uses of resources in a way that an equilibrium gets established. But the problem with the use of market mechanism for filtering is that it is possible to have several market equilibria depending on which tastes and preferences of individuals and firms interact with each other in the market place. *Any* and *every* market equilibrium may not lead to the realization of socio-economic goals. It may, therefore, be desirable to complement the market system by some other mechanism that would help change individual tastes and preferences in a way that would lead to the desired kind of equilibrium. Experience has indicated that moral values can be the most cost-effective complement to the price mechanism for reducing wasteful and unproductive spending and ensuring the realization of socio-economic goals.

Secondly, if coercion is ruled out, then the desired kind of filtering may have to be brought about by motivating all individuals sufficiently to put in their best performance and to abstain from the use of resources in a way that frustrates the realization of socio-economic goals. The serving of self-interest has proved to be an effective motivating mechanism for increasing efficiency, whereas competition, public accountability, and government intervention have helped safeguard social interest. However, it should be possible to safeguard social interest even more effectively if both market mechanism and government intervention were complemented by a sense of moral obligation?

Thirdly, the physical, social, and political environments also influence human behaviour and the use of scarce resources. It may hence be necessary to supplement the filter mechanism and the motivating system by creating an enabling environment of economic, social, and political values and institutions that influence individuals positively in a manner that would be conducive to the realization of human well-

being. This brings into focus the need for socio-economic and political reform. Can such reform be brought about by reliance on market forces alone without a crucial role being played by the society, the state and the educational and religious institutions?

The New Direction

As a result of the various shocks to which capitalism has been exposed during the course of its history, it has changed and is no longer in the same mould in which it was before the Great Depression. The role of the state has become well-recognized. Governments have been playing a role in reducing at least to some extent the suffering resulting from unemployment, sickness, old age and natural catastrophes. In spite of the anathema of capitalism to value judgements, these continued to play an important role because it was not possible for capitalism to become as value neutral in a Christian society as the core of capitalist theory would have desired. And now the role of institutions or rules of behaviour is even getting theoretical recognition as a result of the influence of Institutional Economics.

Mutual trust of market participants is now considered to be indispensable for enabling the market system to function effectively (Arrow 1973; Etzioni, 1988, Fukuyama, 1995, and Hollingswoth and Boyer, 1998). It is widely recognized that trust develops when there is an assurance that the counterparty will faithfully adhere to rules of behaviour and fulfil its obligations even in circumstances in which it would suffer. It is also simultaneously recognized that strong social bonds help in promoting trust and limiting conflict (Hollingswoth and Boyer, 1998, p11), and that family and social solidarity are necessary for this purpose (Fukuyama, 1995; North, 1990; and Polanyi, 1957), something that Ibn Khaldun had emphasized more than 600 years ago (Ibn Khaldun, *Muqaddimah*, p.43). Such solidarity helps exercise external constraints on self-interest. Unless all these constraints operate in sufficient force, the market system will not be able to function efficiently. Can these constraints become effective without willingness on the part of participants in the market, the families, the society and the government to sacrifice?

The cost of enforcing the rules of behaviour may be significantly lower if there is some effective mechanism for self-enforcement. Self-enforcement can come

from two sources. One of these is the innate goodness of the human beings themselves. Within the framework of Islamic beliefs, human beings are good by nature because God has created them in His own image (al-Qur'an, 30:30). They do not necessarily always act in their self-interest. They also act in the interest of others and even make sacrifices for them under a feeling of moral obligation. However, because they are also free, they may not necessarily preserve their innate goodness and may act in ways that are against their nature. Therefore, it is necessary to provide incentives and deterrents as well as an enabling environment. These incentives and deterrents may be this-worldly as well as other-worldly. This-worldly incentives may be in the form of social prestige and ostracization, monetary benefits and losses, or fines and imprisonment. The problem, however, with a number of this-worldly incentives and deterrents coming from the society and the state is that they may be insufficient and may be unjustly implemented or even evaded. Other-worldly incentives and deterrents do not suffer from this weakness because, as indicated earlier, they are managed by an All-Knowing God who is Just and has no axe to grind.

The Islamic Perspective

Therefore, within the Islamic perspective, the mistake that capitalism made did not lie in upholding the role of private property, freedom of enterprise, and market mechanism. These are necessary for the effective operation of an economic system. Any system that does not recognize these is bound to fail, as has been convincingly shown by the failure of Communism. The mistake of capitalism lay rather in ignoring the role that the family, the society, the state, and the metaphysical beliefs and moral values and institutions play in bringing about an allocation and distribution of resources that promotes human well-being? All these can together help keep self-interest within the constraints of social interest and motivate people to make the sacrifices that are needed for ensuring the realization of socio-economic goals. The market mechanism alone is unable to do this.

Fortunately, moral values did not get eroded in capitalist societies immediately. They remained in force and have weakened only gradually. In addition, families and altruistic social groups have tried to serve social interest, and the welfare state also helped reduce the misery of the poor and middle classes. If this were not the case, capitalism would have perpetuated far more misery than what it actually did.

However, now that moral values are losing their force more rapidly, the families are disintegrating, and even the welfare state is being rolled back as a result of the crisis that it is facing, will capitalism be able to promote the well-being of all members of society?

In contrast with this what Islam has done is not to rely on the market mechanism alone for goal realization. It has rather dovetailed the market with the family, the society and the state as well as metaphysical beliefs and moral values, so that all of these together play a role in realizing goals. Since all these involve sacrifice on the part of individuals, it is of crucial importance to introduce a motivating mechanism for the voluntary enforcement of moral values by individuals. Belief in the Hereafter has proved to be very effective for this purpose. Individuals *may* be able to serve their short-term self-interest in this world by being selfish. They cannot, however, serve their long-term self-interest in the Hereafter except by abstaining from wrongdoing and fulfilling their obligations towards other human beings, animals and the environment. The concept of reward and punishment in the Hereafter gives a long-term perspective to self-interest by extending it beyond a person's life span in this world.

Belief in accountability before God thus reinforces competition and government intervention in motivating a person to fulfil his contracts and social obligations faithfully. It helps overcome the limitations of the market, the society and the state in preventing wrongdoing. There are so many clandestine ways of restraining competition and of cheating and exploiting others without being caught that it may be difficult for the market, the state or the society to succeed unless there is an inner urge on the part of operators in the market themselves to do what is right, to fulfil voluntarily their contracts and other commitments faithfully, and not to try to undermine competition or resort to unfair means of earning. In the last analysis, therefore, it may not be possible to safeguard social interest effectively without the help of moral values and without creating an effective motivating force and a proper environment for their enforcement. This should help minimize the burden on the state and the society and also help reduce the transactions costs. The society and the state have, nevertheless, to keep vigilance and to effectively perform their roles to ensure that unscrupulous individuals who have no respect for moral values are not able to get

away with wrongdoing. If some individuals succeed in doing so, then there is a danger that the wrongdoing may tend to become widespread as a result of the contagion effect.

Hence the Islamic message of not recognizing the separation of the material from the spiritual, and of the economic from the social and the political. They are all closely inter-linked and any effort to separate them is bound to jeopardize the realization of human well-being. The moral has to be an indispensable complement to the market, the state, and the society in restraining self-interest and helping the society realize its humanitarian goals. It is of even greater importance in promoting family and social harmony and reducing tensions, crime and anomie. The market, the state and the society cannot succeed in helping realize humanitarian goals unless they operate in a coordinated manner within a moral framework. It is the task of the government and the society to ensure that the rules of behaviour set by the religious worldview get observed by all. This can be done through proper upbringing, education, social prestige and censure, government regulation and supervision, creation of an environment which makes it difficult for anyone to violate these rules, and if necessary, by the use of the state coercive power.

The remedy does not, therefore, lie in a patchwork of cosmetic changes that have been made in capitalism over time. The remedy lies in changing its misconceived worldview. It is necessary to reorganize the whole society, polity and economy in such a way that they operate within the framework of moral values and reinforce each other in transforming the individual from an economic man to a morally conscious human being who is willing to live up to the demands of brotherhood and socio-economic justice. If this is complemented by the several measures adopted by welfare states to help the vulnerable and to reduce inequalities of income and wealth, then there would be greater success in realizing humanitarian goals, particularly if these measures are also supplemented by those that have been incorporated by Islam in its worldview.³ One of these is the morally-oriented social self-help programme in the form of *zakāt* and *sadaqāt* to help those who are not adequately covered by any social security net and stand in need of assistance to

³ See a number of valuable articles in Iqbal, ed. (1988).

alleviate their misery. This can help reduce the burden on the welfare state which it was unable to bear. A second is the inheritance law of Islam to ensure that the estate of a deceased person is equitably distributed among the survivors. A third indispensable measure is the restructuring of the financial system through the elimination of interest. All major religions have prohibited interest because of the great potential that this has in helping reduce inequalities` of income and wealth and instability in the financial markets.⁴ Unfortunately, Muslims have gradually drifted away from Islamic teachings over the centuries during the process of their decline.⁵ However, the revival of Islam that is now taking place in the Muslim world is trying to reverse the decline and to bring the Islamic vision to a reality. Let us pray and hope that this will succeed.

⁴ For an analysis of how the prohibition of interest can help realize humanitarian goals, see Siddiqi, 1983; Karsten , 1982; Khan, 1987; Mills and Presley, 1999; and Chapra. 2000c and 2002.

⁵ For a discussion of the causes of this decline, see Chapra, 2002, pp.173-252.

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